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ECONOMIC OUTLOOK USA

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EDITOR'S NOTE:

ECONOMIC OUTLOOK USA is designed to aid private and public decision makers in achieving a better understanding of the economic and social environment in which they will be operating. The analysis in this publication incorporates direct measurements of the expectations, attitudes and plans of both consumers and business firms with the economic and financial variables traditionally used in forecast models. The philosophy of this publication is that a blend of anticipatory and traditional measures provides richer insights into prospective developments, insights which will produce more consistently reliable forecasts of both economic and social change.

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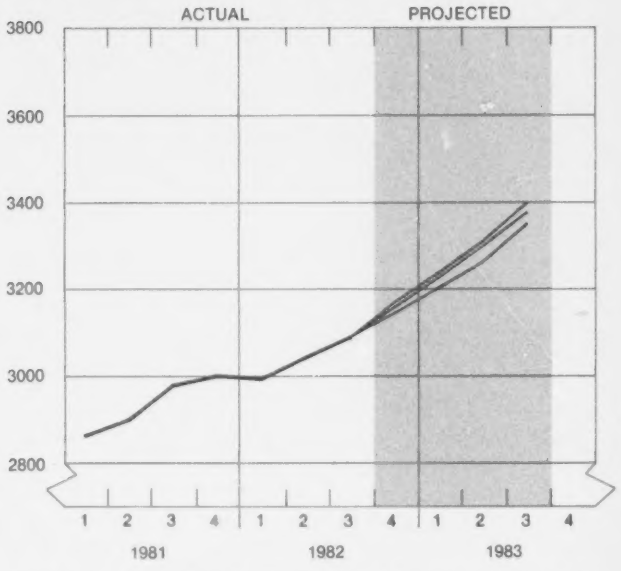
Billions of Dollars



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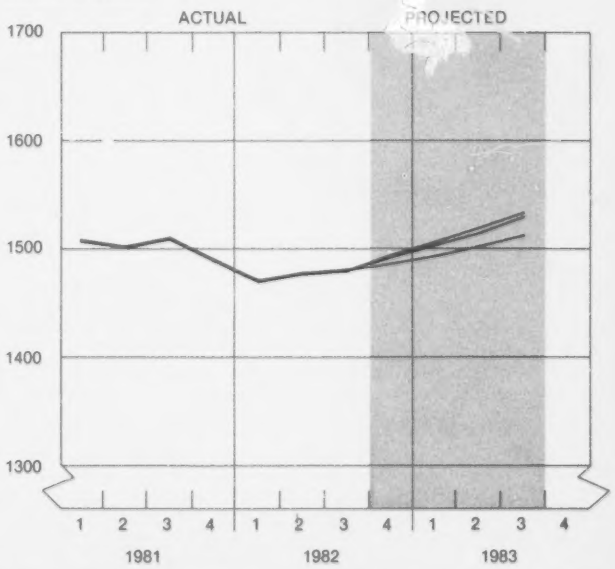
GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



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Crosscurrents of Recession and Recovery

Victor Zarnowitz
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The Uneven Impact and Severity of the Contraction

The declines in nonagricultural employment, industrial production, and the constant-dollar totals of personal income and retail sales attest that the recession continued through September. At the same time, preliminary estimates show small rises in real GNP during the second and the third quarter. It may seem perplexing that this most comprehensive measure of the economy's output should be increasing in the midst of a serious business contraction. But it was the reduction in the rate of inventory liquidation that accounted for the rises in real GNP; final sales in constant dollars evidently declined. It is also known that services, which now represent a very large proportion of national output, have continued to rise, as they did through each of the recent cycles. As usual, the burden of this slump has fallen most heavily on the goods-producing industries: manufacturing (particularly durables), mining, and construction. Ours may be a "service economy" in a significant sense, but services alone cannot sustain the economy's expansion or restore its prosperity.*

Crosscurrents of various sorts often occur near cyclical turning points, making the analysis of business conditions particularly difficult at these critical times. Occasionally the local trends in related indicators are really inconsistent, more often they only appear to be so, but in either case such movements can be seriously, if temporarily, confusing. (Note that, even apart from any problems of conflicting evidence, the current state of the economy is never truly *known* because it takes time (a) to collect and process information, and (b) to distinguish "signal" from "noise"—persistent cyclical movement and trend from short random components in the observed data changes. Thus the present must itself be to a large extent predicted, along with the future proper.)

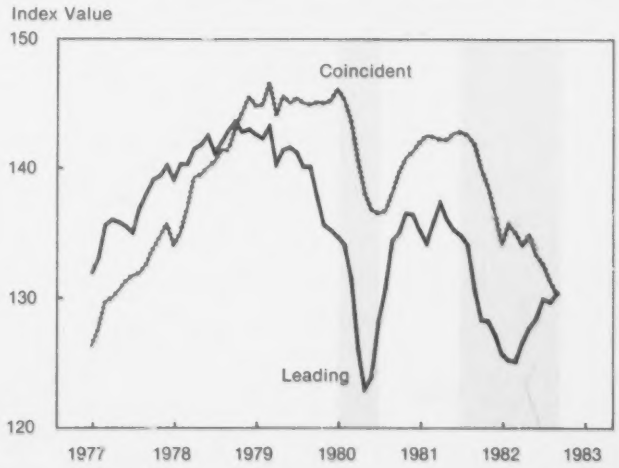
The unemployment rate, at 10.4 percent of the civilian labor force in October, is higher than at any time since the depression years before World War II. Joblessness has spread widely, but it is heavily concentrated in the old "smokestack" industries (the new electronics industries are still hiring) and light in most services. The average duration of unemployment has been rising, too; and long-term unemployment (15 weeks and over) is at its highest recorded (post-1947) level. But these series tend to lag in the sense that unemployment usually continues to rise or stay high for several months after the upturn in real economic activity, reflecting the prevailing uncertainty about the timing and persistence of the recovery. It should be noted that the trend (say, averages across successive cycles) of the total jobless rate has been upward since 1970, in part because of changes in the composition of the labor force. In particular, unemployment had been unusually high (above 7 percent) at the beginning of this recession, in mid-1981, having declined but a little from the level it reached at the end of the previous recession, only a year earlier (see the second chart on p. 95).

*A "countercyclical" rise in real GNP is a rare but not unprecedented event: it occurred for two consecutive quarters during the mild recession in 1970. Apparent conflicts between real GNP (and even its "goods" component) and industrial production (which covers manufacturing, mining, and utilities) are not so uncommon: for example, in the recession of 1974 real GNP declined early, while industrial production remained at a high plateau until fall.

Recent Changes in Cyclical Indicators and their Interpretation

Even while employment, production, and real sales have been declining, a few important indicators have turned up and increased, albeit still weakly and irregularly, in recent months: new housing starts and building permits, new orders for consumer goods and materials in constant dollars, change in the real volume of inventories, change in sensitive materials prices, and real money supply (M2). There are no contradictions here, since the first group consists of "rougly coincident" series that measure aspects of the current economic activity, whereas the second group consists of "leading" series that reflect either anticipations and decisions of households and businessmen or early stages of the production and investment process. The composite index of leading indicators (which is much smoother and generally more reliable than any of its individual components) had a trough in March and rose in each of the four subsequent months, gaining nearly four percent; it then declined very slightly (3/10 of one percent) in August and rose 5/10 of one percent in September according to preliminary data. As shown by the chart below, the trend in this index is still up, although it is weak, foretelling as of now only a slow and uncertain recovery.

Indexes of Leading and Coincident Indicators, January 1977–September 1982 (Monthly Data)



The most frequently and promptly available of the leading indicators is the level of stock prices, which has risen rapidly since its upturn in mid-August, presumably reflecting investors' expectations of lower interest rates, improved business conditions, and higher corporate profits. The Standard & Poor's index of 500 common stocks, which is used in the leading index, gained about 12 percent in September alone and 23 percent between its average July value (the lowest month) and its October 12 reading. (Since then stock prices have been fluctuating rather sharply, but without any clear sign of losing momentum.) The market has been a sensitive predictor not only of recessions but also of major slowdowns in the economy's growth, though some of its contractions provided cyclically false signals, as in 1977; but its record in turning sharply upward before or at the end of each of the eight post-World War II recessions can hardly be faulted (see the last of the charts on page 95).

Bond prices, another historically good leader among the financial indicators, are also signaling a recovery. Of course, this merely reflects the declines in the generally lagging interest rate series. The sharp declines this year are all very recent: for example, the prime bank loan rate remained at 16.5 percent from early March through mid-July, then dropped in a series of rapid steps to 15 percent by mid-August and 12 percent by October 12, where it remains today. To be sure, the long-term rates declined less from higher levels, and institutional rates moved down far more sluggishly than the flexible market rates.

The decline in business demand for credit came late in this recession, which helps to explain the timing of the recent reductions in interest rates. Fears that large government deficits will be monetized with strong inflationary effects may also have contributed to keeping the rates high. The credibility of the Fed's well publicized new policy to reduce inflation by holding the monetary growth rates within low preannounced ranges was for some time low—not surprisingly, in the light of history, the volatility of the results, and problems with defining money in an era of financial innovations, deregulation, and international instability. The pendulum swung toward exaggerated belief in the Fed's power and effectiveness when inflation eventually declined more decisively than had been generally expected. But the disinflation was in large part due to cyclical and structural developments within the economy, as argued below.

The Atypical and Familiar Aspects of Recent Business Cycles

Since 1979 two back-to-back recessions have occurred, with an aborted recovery of barely one year in between, an unusual course of events to say the least. There has been virtually no positive economic growth: according to the latest figures, real GNP is about where it was three years ago, industrial production where it was four years ago. The mid-1981 peaks were scarcely above those of early 1980, and the most recent lows are actually below those of mid-1980 for several important indicators, notably those relating to the levels of activity in manufacturing, construction, and trade. There were indeed two "classical" contractions in this period, defined as absolute declines in the overall measures of economic activity, but if the measurements used deviations from the historical trends rather than levels, only one "growth cycle" could be distinguished consisting of a double wave of below-trend movements.

Some casual accounts take it for granted that the cause of the sluggishness and recessions of the past three years lies in the generally restrictive but insufficiently steady monetary policies. The Fed succeeded in bringing about disinflation but at the inevitable costs of contracting business activity. A policy that would have reduced money growth to the same average rate while keeping it more stable over time would have reduced inflation in much the same way but with less instability in interest rates and output. The view that the Fed is responsible for the recession seems to be presently shared by many monetarists and critics of monetarism alike.

This position may be criticized for neglecting the role of "real" factors as they change over time, shape expectations, induce monetary adjustments, and contribute to business cycle developments. Historically observed regularities still apply to the cyclical behavior of costs, prices, profits, inventories, investment in plant and equipment, and consumer capital outlays.

It is true that the predominantly expansionist policies of the 1965-79 period, far from being consistently countercyclical, increasingly destabilized the economy by justifying expectations of rising inflation and corresponding patterns of consumer and investor behavior. But in the shorter business-cycle perspective the policies were to a large extent reacting to and financially accommodating the movements of the private economy. Price controls and supply shocks (mainly oil price boosts) had important, if episodic, roles in disturbing the economy and disorienting the policy makers. But the new sources of instability did not replace the older ones, namely shifts in aggregate demand and its composition that cause prompter reactions in output and employment than in prices, wages, and real interest rates.

In a market economy, disinflation cannot occur unless the aggregate demand is somehow lowered. A large and lasting disinflation would confer major long-term benefits on the economy (which, let us recall, was only recently plagued by pressures and fears of an inflation that seemed permanent, unpredictable, and beyond control). But the process which may yield this result takes its own course and time. The costs of the sluggishness and unemployment of the early 1980s have been and are high, and it is neither economically nor politically warranted to understate them.

Among the earliest victims in the business world are those active firms that emerged from a period of inflationary expansion saddled with large debts and inventories—more generally, low liquidity and high operating costs. Troubles arise when firms that face weakening demand cannot raise their prices sufficiently to protect their profit margins from falling, and things get worse when declining sales join declining margins to compound the squeeze on profits. Efforts to reduce inventories result in cutbacks of orders and production, followed by reductions of employment. These are typical contractionary processes and they spread and cumulated in this recession in more or less the usual fashion.

A very important and atypical aspect of this cycle has been the occurrence and persistence of historically high real interest rates (differentials between the observed rates and inflation). Even the sharp recent declines in security yields and money market and bank lending rates still leave the real interest rates very high after the long disinflation of the 1980–82 period. Thus the burden of financing costs

in real terms remains heavy, continuing to deter private borrowing for purchases of durable goods, residential construction, and business investment in plant and equipment.

Further declines in interest rates are necessary, and the upsurge in stock prices shows that the market is expecting them. The Fed has signaled a more permissive stance by stating that it will shift its attention from the volatile M1 figures to the better behaved and less restrictive course of M2.

Lower inflation helps to increase real wages, and downward adjustments in expectations of inflation help to moderate wage demands. There are signs that the rise in unit labor costs is decelerating and labor productivity (output per hour) is turning up slowly. Gradual improvements in liquidity, productivity, and profitability, which benefit business, are typical of late stages of contraction and early recovery.

In view of the low capacity utilization rates, however, it is unlikely that business investment demand could revive without a prior rebound in consumer demand. An unusual, and positive, feature of this recession is the relative strength of disposable (after tax) personal income in 1972 dollars, which increased in each quarter between mid-1980 and mid-1982 (gaining nearly 5 percent), except for a small dip in 1982:1. This, plus the fact that the ratio of consumer installment credit to personal income declined steadily from a peak of 14.8 percent in February 1980 to 12.8 percent in July 1982, suggests that consumers are on the whole in reasonably good financial shape. What is not so good is the state of consumer confidence (see the Index of Consumer Sentiment chart on p. 78). As layoffs multiply and new jobs get scarce, many feel that their own jobs are insecure. Seeing business failures and personal bankruptcies on the rise, households, like firms, increasingly undertake to borrow and spend less, and save more, relative to their incomes. However, the process should prove to be self-limiting. There is pent-up demand for housing, cars, and other durables, and consumers will not defer spending indefinitely. Moreover, in the present case, spending attitudes are likely to improve with the developing effects of the most recent tax reduction, lower interest rates, and higher values of stocks and bonds.

Updating Recent Forecasts

The table on page 92 and the charts on pages 74, 77, 81 and 84 show the forecasts from the last ASA-NBER survey. Though now about two months old, in several important respects they still agree with the forecasts that were common as recently as October. Real GNP is to increase at annual rates between 3 and 4 percent in each of the four quarters from 1982:4 through 1983:3, according to the median predictions. Inflation in terms of both the implicit price deflator and the consumer price index is expected to be fairly steady, near the 6 percent level.

Such a weak recovery would not be sufficient to lower the level of joblessness substantially. The forecasters anticipate a slow decline in the unemployment rate, which however would still be as high as 9 percent in 1983:3. A major improvement here would require growth rates in total output of at least 6 to 7 percent in the first year of the recovery. Average growth of this magnitude was indeed recorded after several recent recessions (see the top chart on p. 95). Few forecasters see it as likely in the near future; actually, most have been assigning higher probabilities to the more negative than to the more positive alternatives. But it is well to remember that underestimation of growth during recoveries has been characteristic of a great many past forecasts.

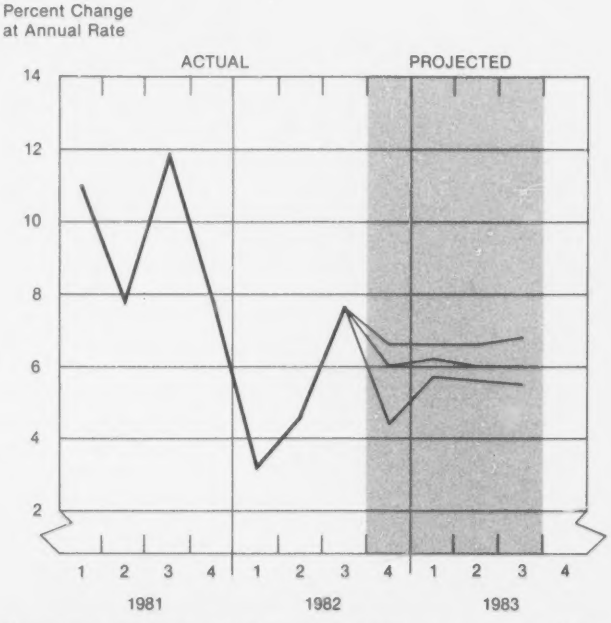
One reason for the pessimism is that the recession proved longer and more severe than most had expected. But it is possible that the pessimism is now overstated, mainly because many recent forecasts assumed that money will grow more slowly and credit will be more tight and costly than seems likely in the light of the latest events. For example, the median ASA-NBER prediction for the 3-month Treasury bill rate in 1982:3 was 10.5 percent, but the actual figure now known is 9.7 percent. In general, only very small and brief declines in interest rates have been anticipated, and the actual declines may well turn out to be larger and less transitory.

A prompt recovery, that is, one beginning in the current quarter, is still widely forecast, although good support for its imminence cannot yet be found in the statistics on the state of the economy. Some hopeful signs have emerged and they are significant, but there is no assurance that the distressful unemployment situation will soon be relieved.

November 1982

Editor's Note, 11-19-82: Today's revision of Commerce Department statistics indicates that real GNP did not increase during the third quarter but remained unchanged from its 1982:2 level. This strengthens the conclusion that the recession continued at least through September.

CONSUMER PRICE INDEX



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Consumer Spending Plans Remain Cautious

Richard T. Curtin
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Survey Research Center
The University of Michigan

Sentiment Unchanged at Low Levels

The Index of Consumer Sentiment was 66.7 in the third quarter 1982 surveys, less than one Index point different from the three prior quarterly readings. One year earlier, in the third quarter of 1981, the Index stood at 74.8, more than 20 Index points above the all-time low recorded in mid-1980. Subsequently, the Index fell nearly 10 points in late 1981 due to record interest rates and has remained at low levels due to persistently high levels of unemployment (see the chart below).

The current level of consumer sentiment reflects not only a cyclically low level but also a long-term downward trend. Consumer attitudes and expectations have been more pessimistic on average throughout the past 10 years than in the prior two decades. From 1973 through the third quarter of 1982, on average half of all consumers expected bad times in business conditions during the following one and five year periods. This proportion stands in sharp contrast to the prior two decades. From 1953 to 1972, half of all respondents expected good economic times in the near term and one-third expected good times over the longer term (see Table 1).

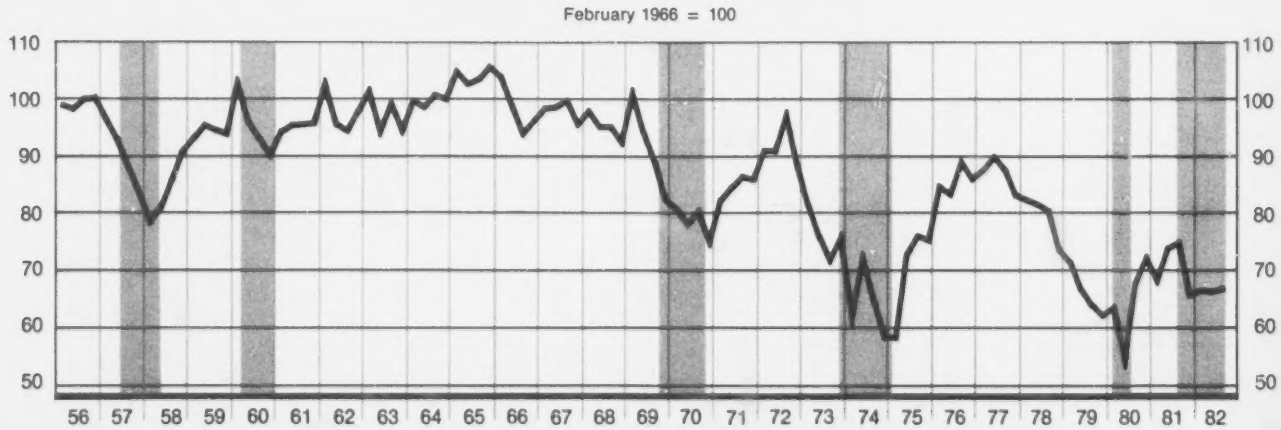
Consumer evaluations of their personal financial situation have also been less favorable on average during the past decade. In the 1950s and 1960s consumers more frequently reported improvement in their personal financial situation than deterioration. From 1973 to 1982, however, consumers more frequently reported that their financial situation had worsened rather than improved. During the past 10 years a less favorable outlook for future improvement in personal finances has also been recorded. From 1963 to 1972, four times as many families expected future improvement rather than deterioration in their financial situation. In contrast, from 1973 to 1982, although the balance of opinion remained favorable, the favorable margin was considerably reduced: from a ratio of four-to-one to just over two-to-one expecting improvement.

These data indicate that, rather than a source of consumer satisfaction and confidence, the economy since the early 1970s has become a source of discontent and uncertainty. Subsequent cyclical increases in consumer sentiment can now occur only within the context of an overall unfavorable economic environment. The increase in uncertainty and confusion has led to more volatile attitudes and expectations, making cumulative improvements in sentiment more difficult to sustain. At the same time, the pervasive unfavorable economic experiences recorded during the last decade will also result in less pressing personal aspirations and less demanding performance expectations for the entire economy. Whereas the rapid pace of economic accomplishments in prior decades led to ever-rising aspirations and expectations, their continued frustration and nonfulfillment promotes reassessment and downward revisions.

Unemployment Dominates Views on Economy

Throughout 1982 concern with spreading unemployment has dominated consumer views of the economy. Four-in-five respondents in the third quarter 1982 surveys thought that the economy had worsened during the past year, a level which has remained largely unchanged since the start of 1982. When respondents were asked about recent developments in business conditions, unemployment was reported more frequently in the third quarter than at any other time in the last quarter century. Among all families, 52 percent spontaneously mentioned hearing about increases in unemployment when asked about news of the economy. This was three times the level recorded in the third quarter 1981 surveys (17 percent) and consider-

INDEX OF CONSUMER SENTIMENT



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

TABLE 1: Trends in Consumer Sentiment, 1953-1982

	Business Conditions Expected During...						Personal Financial Situation...					
	Next 12 Months			Next 5 Years			Compared to a Year Ago			Expected in a Year		
Ten Year Average	Good	Bad	Good Minus Bad	Good	Bad	Good Minus Bad	Better	Worse	Better Minus Worse	Better	Worse	Better Minus Worse
1953-1962	59%	13%	+46	35%	19%	+16	32%	24%	+ 8	32%	6%	+26
1963-1972	56	20	+36	32	27	+ 5	35	21	+14	36	9	+27
1973-1982	30	50	−20	20	51	−31	31	37	− 6	38	18	+20
Addendum:												
3rd Quarter 1982	27	63	−36	24	56	−32	30	41	−11	31	18	+13

ably above the prior recession peaks in the second quarter of 1980 (37 percent) and in the first quarter of 1975 (47 percent). Importantly, this record level of concern with unemployment was recorded prior to the announcement of the 10.1% unemployment rate for September 1982.

Unemployment was expected to increase further by 46 percent of all families in the third quarter 1982 surveys, just below the 48 percent recorded in the prior quarter. Unemployment expectations have been unfavorable throughout 1982, with four-in-five respondents expecting unemployment either to increase further in the year ahead or remain unchanged at current record high levels.

Unemployment rather than inflation continued to be viewed as the more serious economic hardship facing the nation as it has been throughout 1982. In the third quarter surveys, unemployment rather than inflation was seen as the more serious problem by a three-to-one ratio of families (66 versus 23 percent). This ratio represents the highest margin of concern with unemployment as opposed to inflation ever recorded.

Expectations for improvement in business conditions were somewhat less optimistic in the third quarter surveys than in the prior quarter, but on balance more favorable than unfavorable expectations were recorded. When asked why they expected business conditions to improve or worsen, substantially fewer respondents in the third quarter 1982 surveys expected government economic policies to have a favorable impact on business conditions (12 percent) than in the third quarter 1981 surveys (25 percent). At the same time, unfavorable references to government economic policies rose to 13 percent to completely offset favorable references. Overall, in the third quarter surveys confidence in government economic policies to reduce unemployment and inflation remained near the lowest level recorded thus far under the current administration. Among all families, almost twice as many rated government economic policies as poor rather than good (18 versus 33 percent), in sharp contrast to the favorable balance of opinion recorded one year earlier (30 versus 21 percent).

Postponement of Purchases Persists

Declines in interest rates have been a prevalent expectation among consumers since the start of 1982. In the third quarter 1982 surveys, nearly twice as many consumers expected interest rates to decline rather than to increase in the year ahead (40 versus 22 percent). The recently announced declines in market interest rates have acted to confirm expectations and have made consumers more resistant to the current rates charged on consumer loans. The third quarter surveys recorded continued widespread postponement of purchases due to high interest rates: among all families, 34 percent said they had postponed purchases, unchanged since the fourth quarter 1981 surveys (see Table 2). The type of purchase most frequently postponed was vehicles (13 percent), followed by household durables (10 percent) and housing and home repairs (9 percent).

Despite the widely announced declines in market rates, the median interest rate reported as the rate that would have been changed on the postponed purchase was 17.6% in the third quarter 1982 surveys—a figure that has remained largely unchanged since October 1981. Consequently, these surveys offer no evidence that consumers have yet experienced lower rates on consumer loans. The highest rate that consumers would have been willing to pay to make these purchases has remained at 12%.

Buying Conditions Unfavorable

Attitudes toward buying conditions for houses, vehicles, and household durables have remained near record low levels for nearly two years. Since the start of 1981, the proportion of American families that rated buying conditions

TABLE 2: Interest Rate Effect on Consumer Purchases During the Past Year

	1981:4	1982:1	1982:2	1982:3
Proportion postponing purchase	34%	33%	32%	34%
Interest rate that would have been charged on postponed purchase*	17.5%	17.7%	17.5%	17.6%
Highest interest rate willing to pay to make purchases*	11.9	12.0	11.9	11.9
Difference between interest rate charged and that willing to pay*	4.7	5.1	5.1	5.3

*Median values for families who postponed a purchase.

The questions asked were "Have interest rates caused you to postpone making any purchases during the last six months? What was postponed? What interest rate would have been charged on any money borrowed for (item)? What is the highest interest rate at which you would have purchased (item)?"

for houses unfavorably has remained in the narrow range of 71 to 76 percent in the seven quarterly surveys (71 percent in 1982:3). Unfavorable attitudes toward market conditions for cars have ranged from 50 to 54 percent in the past seven quarterly surveys (52 percent in 1982:3), and unfavorable market conditions for large household durables were reported by 34 to 43 percent of all families in the last seven quarters (42 percent in 1982:3). This persistently unfavorable view of market conditions has resulted from high interest rates.

Concern with interest rates first reached record levels in the second quarter 1980 surveys (when the Carter administration announced a credit restrictions program) and, following a brief decline in late 1980, returned to record high levels. The proportion of families that mentioned high interest rates when asked about market conditions for houses rose to 72 percent in the second quarter of 1980 and stood at that same level in the third quarter 1982 surveys, although it was somewhat below the peak level of 81 percent recorded in late 1981. With regard to the car market, 25 percent of all families mentioned unfavorable credit conditions in the second quarter of 1980, and those mentions rose subsequently to an all-time peak of 29 percent in the third quarter 1982 surveys. Complaints of high interest rates in the household durables market reached an all-time peak of 28 percent in the second quarter of 1980 and remained at 22 percent in the third quarter 1982 surveys. In contrast to the prevalence of interest rate complaints during the past several years, in the second quarter of 1978 (two years prior to the initial record levels) just 11 percent mentioned high interest rates with regard to the housing market, and just 3 percent mentioned unfavorable credit conditions in the car and durables markets.

The dominant reaction to high interest rates has obscured other important shifts in consumer reactions to market prices. In the late 1970s, consumer reactions reflected both an aversion to high prices and a willingness to buy in advance of further price increases. At that time, consumers rarely mentioned the appeal or availability of low prices. By the third qurater 1982 surveys, however, buy-in-advance price rationales were mentioned by less than 10 percent of all families when asked about the housing and car markets, down from the 30-40 percent range in the late 1970s. Throughout 1982, families have more frequently mentioned price declines and the availability of discounts and rebates. With regard to the housing market, 13 percent of all families mentioned lower prices in the third quarter 1982 surveys, up from just 5 percent one year earlier. Thus far the 1982 surveys have recorded more mentions of low housing prices and fewer complaints about high prices than at any other time during the past decade. With regard to the automobile market, 27 percent mentioned the availability of lower prices and rebates in the third quarter 1982 surveys, down from 35 percent in the second quarter, but well above the 17 percent recorded one year earlier.

During the past year, when respondents were asked to explain why they thought buying conditions were good or bad, a significant proportion referred to the inability of families to make such purchases due to unemployment and income declines, rather than mentioning market prices or supply conditions. This lack of income discretion was cited by 20 percent of all families when asked to evaluate buying conditions for household durables in the third quarter 1982 surveys, up from just 8 percent one year earlier. In the housing market, the lack of income ability to make purchases was cited by 23 percent of all families in the third quarter surveys, up from 13 percent one year earlier. Similarly, this reason was mentioned in the automobile market, rising from 6 percent in 1981 to 13 percent in 1982.

Income Declines Widespread

The financial situation of American families remained unfavorable in the third quarter of 1982, despite widespread expectations of improvement in the year ahead. In the third quarter surveys, 41 percent of all families reported that their financial situation had worsened during the past year, while 30 percent reported improvements. When asked to explain how their financial situation had improved or worsened during the past year, more families mentioned income declines in the third quarter surveys (22 percent) than at any other time during the prior two decades. Partially offsetting these unfavorable income trends, somewhat fewer respondents mentioned the adverse impact of inflation on their family budgets during the past year. Importantly, the incidence of income declines was just as great among families with incomes of $20,000 or more.

Nearly twice as many families in the third quarter 1982 surveys expected their personal financial situation to improve rather than worsen in the year ahead—31 versus 18 percent—a level that has remained largely unchanged during the past two years. The maintenance of personal financial expectations at these favorable levels has been due to lower expected price trends. Although income expectations have weakened somewhat in the past year, they did not decline as much as price expectations, leaving real income expectations more favorable. In the third quarter surveys, more families expected their incomes to remain unchanged or to decline in the next 12 months, and fewer families expected income increases of 10% or more compared with year-earlier readings.

Concern with unemployment and income declines has led most consumers to remain cautious in their spending plans. Most consumers are not yet willing to incur new debt or use accumulated savings to make large purchases. In the third quarter 1982 surveys, 72 percent of all families said they were reluctant to use savings to make large purchases, up from 68 percent one year earlier and 54 percent two years earlier. Reluctance to use credit to finance major purchases was reported by 85 percent of all families in the third quarter surveys, up from 63 percent one year earlier. Overall, consumers expressed greater reluctance to draw on savings and incur new debt to finance purchases in the third quarter of 1982 than at any time in the prior two years.

Tax Cut Offers Little Help

How will the latest installment of the tax cut legislation affect consumer incomes and their willingness to make discretionary purchases? In the third quarter of 1982, respondents were asked whether they expected their monthly take-home pay to change as a result of the tax legislation, repeating questions asked in 1981 (see Table 3). Fewer respondents reported that they expected their incomes to increase in the third quarter (29 percent) than in April-May 1981 (46 percent). Not only did fewer families expect income increases, but the expected amount of the

TABLE 3. Expected Change in Monthly Take-Home Pay Resulting from Personal Income Tax Reductions

Expectations and Plans	1981:2	1982:3
Expect Take-Home Pay to...		
Increase	46%	29%
Stay the same	40	54
Decrease	2	6
Doesn't pay taxes	6	7
Don't know	2	1
Not ascertained	4	3
	100%	100%
Expected Increase in Monthly Take-Home Pay		
Median amount	$50	$23
Planned Use of Increase in Take-Home Pay		
Spend	25%	43%
(on new purchases)	(8)	(8)
(on current expenses)	(17)	(35)
Repay debt	21	22
Save, invest	41	25
Both spend and save	4	4
Don't know; not ascertained	9	6
	100%	100%

The questions asked were: (April-May 1981) "If the personal income tax reductions were actually passed, would you expect your monthly take-home pay to increase, stay the same, or what? (If 'increase') About how much more money would you expect to take home each month? What do you think you would do with this money—spend it, save it, invest it, repay debts, use it for a down payment on something, or what?" (Third quarter 1982) "As a result of the 1982 federal tax cut, would you expect your monthly take-home pay to increase, stay the same, or what?" [Remainder of question same as in 1981.]

increase in disposable income also declined sharply during the past year. Among those families that expected increases in their take-home pay, the median monthly increase was $23 in the third quarter of 1982, half the $50 expected in April-May 1981. When asked whether the increase in their take-home pay would make a considerable difference, a small difference, or practically no difference in their financial plans, 50 percent of the respondents that expected increases in take-home pay reported that the amount of extra income would make practically no difference.

When asked whether they planned to save or spend the increase in after tax income, families more frequently reported spending plans in the third quarter of 1982 (43 percent) than in April-May 1981 (25 percent) and less frequently reported saving plans (25 percent versus 41 percent). Although spending rather than saving plans increased during the past year, since fewer families expected increases, the net spending stimulus was left largely unchanged. Moreover, even though the frquenty of spending plans sharply increased during the past year, the major portion of this increase occurred not in plans for making major new purchases, but rather in increased expectations that these funds would be used to cover everyday expenses.

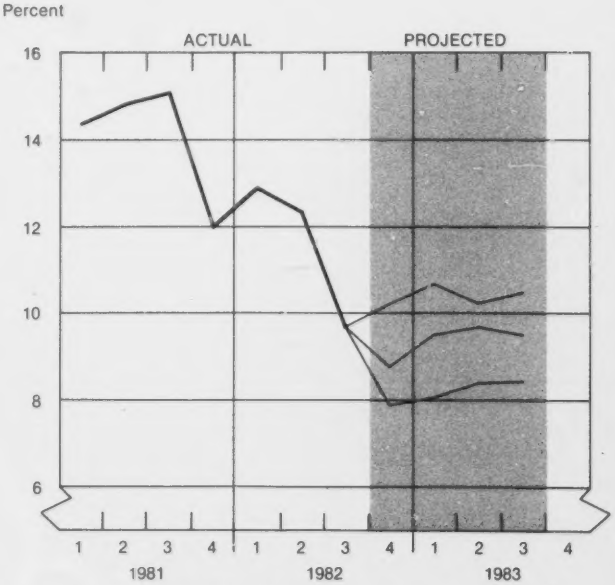
Significant differences exist between income subgroups in both the frequency of expected increases in monthly take-home pay and the planned use of the income increase. In the third quarter 1982 surveys, 42 percent of respondents with incomes of $25,000 or more expected an increase in their take-home pay, compared to only 16 percent of those respondents with incomes of $15,000 or less. Although high-income families more frequently planned to spend the increase in after-tax income, the vast majority of spending plans among all income groups was to meet current expenses rather than for new purchases. Plans to save the increase in take-home pay were reported somewhat more frequently by high income families; lower income families were somewhat more likely to report that they planned to repay debt. Consequently, when the saving and debt repayment plans are combined, the net saving motivations show little difference across income subgroups.

Summary Outlook

Consumer sentiment has remained largely unchanged at low levels throughout 1982. Widespread concern with unemployment has weakened confidence in government economic policies, despite declines in inflation. High interest rates on consumer loans have thus far blocked any improvement in consumer sales. And because interest rates are widely expected to decline, consumers have become more resistant to the current high interest rate levels. Declines in consumer loan rates will release pent-up demand, but increases in consumer sales will be constrained by personal financial uncertainty, not significantly eased by the recent tax cut.

October 1982

90-DAY TREASURY BILL RATE



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Social Security Entitlements: The Economics and the Politics

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Virtually every serious discussion of ways to reduce the size of federal government expenditures, and thus deficits, over the next several years ends up with the conclusion that the problem cannot be solved unless adjustments are made to the defense budget and to all the major entitlement programs, including Social Security. The reason for that politically unpalatable conclusion is simple: the combination of social security payments and defense expenditures now comprises over half of federal government expenditures, and that proportion is bound to grow over the next several years. If that much of the budget were sacrosanct, with interest on the national debt amounting to another 12-plus percent and other mandatory retirement programs adding another 10 percent or so, it would hardly be possible to cut the remaining expenditure categories sufficiently to help solve the deficit problem.

This essay focuses on the social security issue, and examines both the economics and politics of the problem. The basic issues are these: Is there an argument based on either equity or incentives or both that social security benefit programs should not be pared back below the increases contained in current law? And what is the evidence to support the widely held view that politicans advocating such a modification face inevitable defeat at the polls?

The Economics of Social Security

One could make the case that there is no important economic and social institution so little understood by the public as the U.S. social security system. While public discussion tends to focus on questions of financial solvency (will there be any money in the trust fund in five years?) or questions of obligation (benefits can't be adjusted because people are entitled to get what they have put in), the real issues are a quite different set.

I would categorize the central issues relating to the social security system as follows:

1. Does the system make adequate provision for generating the capital, and thus the real output and consumption levels, needed to maintain long-term growth in benefits, given predictable changes in the dependency ratio (the "workers to eaters" ratio) over the next several decades?
2. Does the system provide a real return on investment that is attractive enough so that beneficiary groups with alternatives (employees of nonprofits, or those working for state and local governments) do not choose to "opt out," and groups not now included (federal government employees) can be "opted in" without disadvantage?
3. Are present and prospective recipients of social security sufficiently well-off economically so that benefit levels or eligibility criteria could be modified without doing violence to general considerations of equity and fairness vis-a-vis other groups in the population?

The first two of these issues are technically complex and may imply fundamental modification of the system: they will be the subject of future *Outlook* essays. The third, which relates more to minor modification than fundamental change, is the subject of this essay.

Without doing great violence to the facts, we can think of the social security system as a basic tax and transfer system. People are taxed while they are working, and they receive benefits when they retire. The link between social security benefits and previous tax payments, while it exists, is not very tight (as it would be in a private pension system).[1] And benefit levels are not a matter of inalienable right: benefits have been substantially changed by legislation in the past, invariably to increase them.

Accepting that as a reasonable description of the system, real issues exist—but they are not the ones often discussed in the political arena. The system has significant effects on income distribution, is a major determinant of the size of the poverty population, has significant overtones of equity and of fairness with respect to the treatment of older citizens, and is thought by some to have significant effects on economic efficiency by way of its influence on labor supply and saving behavior. These issues are in need of discussion.

Some Background

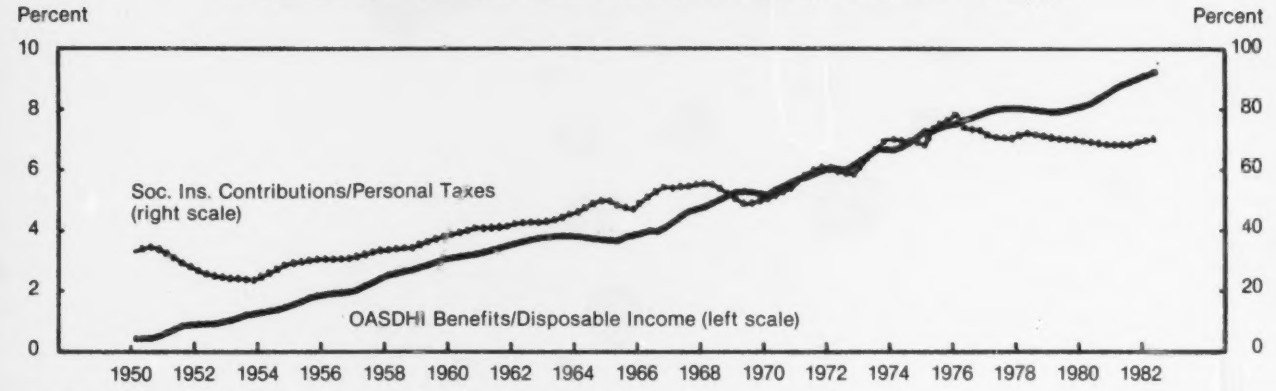
It is useful to look at a few numbers which reflect changes over the last several decades in the social security system. The first thing to note is that social security benefit levels have risen consistently over this period. The social security taxes paid by the working population have also risen substantially, and now approach the order of magnitude of personal income tax payments. As the chart clearly shows, the real value of social security benefit payments has risen more than other components of disposable income over the last several decades, reflecting legislative intent to improve the living standards of the elderly population.[2]

That these efforts have been successful is not in dispute: the data show that the economic status of elderly families has improved relative to the economic status of all U.S. families and that this improvement has been very substantial during the last several decades. Similar results are shown by comparisons of the proportions of different population groups with incomes below the poverty line—here the data show that by the middle of the 1970s the proportion of households defined to be in poverty was actually

[1] Historically, people have gotten a pretty good buy for their social security taxes, although that will be less true for people (cohorts) who are now working and will retire in the future.

[2] The secular rise in benefit levels is a compound of legislative improvements in social security benefits relative to social security tax payments and improved earnings histories that warrant higher benefits at the same contribution/benefit relation.

Ratios of Social Security Benefits to Disposable Income and Social Insurance Contributions to Personal Tax & Nontax Receipts



Note: Displayed data are four-quarter moving averages of the series.

lower for households with 65-and-over heads than for those with heads under 65. And these data show unambiguously that the principal reason for the rising relative economic status of the elderly, as well as for the decline in the incidence of poverty among older households, has been the substantial growth in social security and other income support programs.[3]

The measurement of economic status is a tricky business at best. One needs to be concerned not only with conventional sources of money income like earnings and social security payments, but also with "in-kind" income transfers like food stamps and medical insurance; with differences in family size and composition that make the consumption standards of families differ markedly even though they have the same money income; with differences in tax payments at the same money income level; with differences in both tangible and intangible asset holdings that reflect differences in future consumption standards; with differences in work expenses between the retired and nonretired parts of the population; and so on.

Taking into account as best one can all these multiple sources of differences in economic status, the best available estimates present the following picture:[4]

1. By 1973, when the data permit a number of the more subtle adjustments to be made, the average economic status of households with heads 65 and over was something like 90 percent as high as the average economic status of households with heads under 65.
2. By 1976, the proportion of households below the poverty line (counting in the poverty definition only after-tax income plus cash transfers and certain in-kind transfers) was *lower* for households with heads 65 and over than for those with heads under 65.
3. Between 1973 and 1981, the ratio of average (median) money income for elderly households to the average income for all households *rose* by about 20 percent.

All that represents good news for the economic status of the elderly. But the numbers are seriously misleading in one respect, and possibly in another.

The data just discussed relate to economic status measured for a particular time period—one year. But we know that there are important differences between households who are poor (or near poor) for a single year and those who are poor (or near poor) all the time: one group has had an adverse turn of the dice from which they will normally recover, while the other is mired in an economically depressed state more or less permanently.

From the Michigan Panel Study of Income Dynamics, we know that the elderly poor are much more likely to be permanently poor while the nonelderly poor are more likely to be poor only temporarily. Thus an observation of rough equality in overall poverty rates for any particular year means that the elderly have much higher "persistent" poverty rates than the nonelderly, lower "transitory" poverty rates.

Second, the data reflect average or mean income levels for groups and ignore variation in income among households *within* each group. Income inequality is typically greater among the elderly than among others, and the equality of averages hides a disparity in the proportions of households in the lower half of the income distribution. One reflection of that difference is the substantially larger proportion of elderly than nonelderly households who are "near poor"—above the poverty line but just barely.

Keeping these qualifications in mind, it is roughly correct that the present economic status of elderly households is, *on average*, about the same as the economic status of nonelderly households and that the proportion of elderly households who are poor is about the same as the proportion of nonelderly households who are poor. Thus the substantial gap that had existed during the 1950s and 1960s between the living standards of the elderly and of the nonelderly had been largely closed by the 1980s. But those generalizations hold *on average*; significant subgroups of the elderly population—female-headed households, blacks, those with disabilities—are clear exceptions.

All that is by way of saying that there is little or no case to be made on equity grounds that social security entitlements should be exempt from examination and possible modification because it would disadvantage people who,

[3]See F. Thomas Juster, "Current and Prospective Financial Status of the Elderly Population," in *Saving for Retirement*, ed. Philip Cagan, sponsored by ACLI and Columbia University Graduate School of Business.

[4]See S. Danziger, E. Smolensky, M. Taussig, J. van der Gaag, "Implications of the Relative Economic Status of the Elderly for Transfer Policy," paper prepared for the Brookings Institution Conference on Retirement and Aging, October 21-22, 1982.

on average, are distinctly worse off than other citizens. Yet there seems to be little public discussion of the issue in these terms. Rather, most of the discussion sounds as if people are talking about a period when the elderly population was substantially worse off than the nonelderly, had few resources to enable them to live with dignity during retirement, were forced to double up with married children in order to survive economically, and could reasonably be portrayed as in need of special consideration. But the world is no longer like that, for which we should be thankful.

It is important to keep in mind that this analysis, while it relates to sophisticated concepts of economic status, does not take into account the special circumstances of some elderly members of the population. Besides the continuing problem of persistent poverty among some elderly households, especially among female-headed and black households, older people are in poorer health, are less mobile, are less able to adjust to misfortune, and may have more real variation in life circumstances for any given level of measured income, than the population generally. But those very real factors do not affect all the elderly, and they tend to suggest special treatment for some subgroups rather than special treatment for the elderly as a class.

Political Considerations

Over the course of the last several years, any number of policies have been advanced which would have the effect of paring back scheduled rates of increase in social security entitlements. These proposals include putting a cap on the cost-of-living adjustment formula; subjecting social security benefits to income taxation; substituting for the present cost-of-living adjustment an adjustment equal to the rate of increase in wage rates or the rate of increase in prices, whichever is lower; and slipping the annual cost-of-living adjustment by a three-month or six-month span.

Whenever any of these policies has been even tentatively advanced by one of the major political parties, the resulting uproar from the other party has been deafening. Any talk of modifying social security entitlement programs touches a tender political nerve, and everyone who has advanced such a proposal has quickly retracted it. One has to attribute that to the real or alleged political power of older citizens and, perhaps more to the point, to the stance taken by organized groups who represent the interests of older Americans.

It is not unreasonable to ask: is it in fact true that America's 65-and-over citizens would uniformly march to the polls to oppose any political figure who suggested that social security entitlement programs were in need of modification? The conventional political wisdom apparently answers that question with a resounding yes.

While there is no direct evidence that this conventional judgment is incorrect, I suggest that it seriously misrepresents the political risks. No doubt many older citizens are very sensitive to modifications of programs on which their living standards depend, as they have every right to be. But there is a good deal of indirect evidence that people do not always vote for what is in their own narrowly defined self-interest and that the citizenry generally is sensitive to issues of fairness, equity, and burden-sharing.

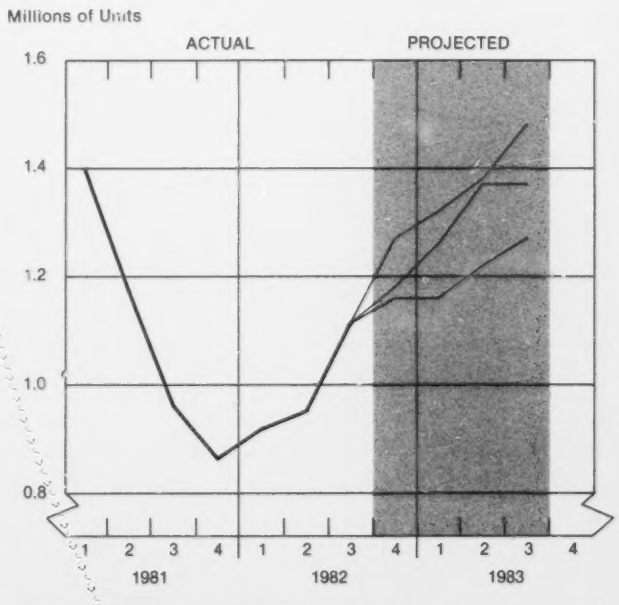
We have over the years put in place programs to ameliorate the harshness of poverty, not just for older Americans but for others who lack skills or adequate earning power, who have physical or mental disabilities, whose incomes are temporarily low, who have young children to take care of and insufficient income to meet those responsibilities, etc. The citizenry has generally been supportive of such programs, although people now seem to worry more about possible program abuses rather than the possible omission of those who might be eligible.

None of these considerations guarantees that the political sensitivity of policy discussions relating to social security entitlement programs is grossly overestimated. My best guess is that the issue is not so politically sensitive as is often supposed and that older citizens are just as responsive to considerations of evenhandedness and burden-sharing as are citizens generally.

Moreover, I think that a persuasive case can be made that some paring back of the scheduled increases in social security entitlement programs, say by making a part of such benefits subject to income taxation, actually constitutes a policy of evenhandedness: that without tackling such programs, progress on solving budgetary problems is difficult if not impossible; that the relatively small proportion of the elderly population whose economic status would be severely impacted by program modifications have other federal programs to fall back on; and that it is the function of responsible political leadership to address such issues in a serious way. As a minimum, a dialogue that took the form of a serious discussion of the relevant issues would constitute a breath of fresh air.

November 1982

NEW PRIVATE HOUSING UNITS STARTED



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Joblessness and Discouragement among Black Americans[1]

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Joblessness in America is currently a critical economic, social, and political problem. The latest government statistics show that joblessness in October of 1982 reached 10.4 percent, the highest rate since the Great Depression. The official jobless rate among black Americans is typically about twice that of whites, reflecting the particular severity of this problem among the nation's largest racial-minority group.

While the comparatively high and steadily rising jobless rates among blacks are alarming, these official unemployment figures do not include the jobless black Americans who are the hardest hit. The number of "discouraged workers," whom the government omits from unemployment totals because they have stopped actively looking for work, rose 140,000 during the first 3 months of 1982 to 1.3 million. This represented the largest number of workers who reported no job search activity because they had given up hope since the government began keeping records on such discouragement in 1967. By July of 1982, the number had jumped another 200,000, with 1.5 million reporting that they were not actively looking for a job because of discouragement. Available data show that job search discouragement is even more severe among black Americans than official unemployment. While blacks comprise roughly 10 percent of the population, they constitute 20 percent of the unemployed and nearly 40 percent of the discouraged who are no longer looking for employment. Even this striking proportion is a conservative estimate since it is suspected that large numbers of blacks (particularly discouraged males) are never enumerated in government surveys of households.

To become so discouraged in job search that one gives up hope can be a devastating experience with widespread psychological and social ramifications. However, a review of existing research shows inconsistent definition and measurement, conflicting findings, and a tendency to ignore the psychological and social dynamics involved in discouragement among the jobless. What is clear, however, is that blacks are particularly vulnerable to discouragement and that the phenomenon is highly concentrated among secondary workers—youth, older persons, women, and the unskilled. The focus has also been primarily on macroeconomic implications of discouragement, with little attention given to the mental health, human service, and social consequences associated with losing hope of finding a decent job. More research is needed to better clarify the nature, conditions, and consequences of job search discouragement among blacks and other severely affected groups.

To begin to address this issue we used data collected in late 1979 and 1980 from a survey of a national cross-section sample of the adult black population living in the continental United States. Professional black interviewers completed 2,107 face-to-face interviews averaging two hours and twenty minutes in length. The respondents ranged in age from 18 to 101 years old; 1310 were females and 797 males.

A wide range of measures were obtained in several major areas—employment experience, neighborhood life, religion, mental and physical health, informal social support, resource utilization, racial identity, and political consciousness and social background. The preliminary analyses reported here utilize measures on employment experiences and several indices of psychological well-being. Three central questions are explored in our preliminary analyses:

1. How do we measure and assess "hidden unemployment" and the extent of discouragement in job search?
2. How do discouraged workers interpret their economic predicament—i.e., what patterns of causal attribution do they express?
3. What is the relationship between job search discouragement and indices of psychological distress?

Joblessness and Discouragement among Black Americans

A series of measures were employed to estimate the extent of joblessness and job search discouragement in our national sample of black Americans. Nearly 57 percent of the sample were working for pay, with 43 percent (907 respondents) not working. These jobless respondents can be classified as officially unemployed only if they had specifically looked for a job within four weeks immediately prior to the interview or were laid off and waiting to return to a job. Two hundred respondents met this criterion: 81 were officially laid off and 119 reported that they had searched for a job within four weeks of the interview. These 200 respondents represent 14.3 percent of the labor force,[2] which is the official unemployment rate in this national sample. These 200 officially unemployed respondents are only 22 percent of the 907 respondents in the sample without jobs.

The portion of the jobless classified as officially unemployed must be distinguished from the hidden unemployed who are interested in working but not actively looking for a job. In addition to the 22 percent "officially unemployed," five percent of the jobless (41 respondents) reported looking for a job but not actively enough to be classified as officially unemployed. An additional 22 percent (203 respondents) indicated, in response to our interview questions, that they were "interested in working" and

[1]This article is adapted from a presentation by the first author at the 1982 convention of the American Psychological Association. A more extensive version of this paper is available upon request.

[2]The active labor force is defined as all persons either employed or officially unemployed.

"would take a job if you were offered one." Another nine percent (82 respondents) indicated that they were interested in working although they would not be able to take a job at the time they were interviewed. Only 42 percent of the jobless resondents indicated that they were not interested in working. Thus, jobless blacks include both the officially unemployed and a large number of hidden unemployed. Although the hidden unemployed are not considered members of the active labor force, their orientation to the labor market is different from those not interested in working.

The hidden unemployed, similar to those who are not interested in working, will often emphasize homemaker responsibilities, physical disabilities, going to school, and age as constraints to active job search. Some of the hidden unemployed, however, also emphasize frustration in job search; and many even say that they have given up hope of finding a job. In an attempt to get directly at the issue of job discouragement, all jobless workers—those looking for a job as well as those not looking—were asked whether they had lost hope that they could find a decent job.[3] In our sample, 11 percent of the jobless workers (103 respondents) reported that they had lost this hope. Half of them (50 respondents) had stopped looking for work, but half (53 respondents) were still looking for work and therefore part of the "official unemployed," continuing a ritualistic quest for a job despite their discouragement. Moreover, among the jobless who were still looking for work and had *not* completely lost hope, the response to another question in the interview indicated that many of them were also somewhat discouraged: about two-thirds of them indicated that it had been "almost impossible" or "extremely hard" to find a job they wanted. These findings suggest that discouragement is not only a problem for the hidden unemployed who have dropped out of the labor force, but also for the officially unemployed who continue to look for a job.

We should note that the figures on both hidden unemployment and discouragement would be slightly higher if involuntary part-time workers were included. Thirty-three of our respondents were employed for less than 20 hours per week and indicated that they would like to work more hours. In the subsequent analyses of discouragement in this paper such workers who are employed for less than 20 hours per week but desire a job with more hours will be included.

In our on-going analyses of job discouragement we are exploring many of its social psychological correlates. In the remainder of this paper we will briefly discuss some findings related to two sets of these correlates: the respondents' attributions of responsibility for their joblessness, and the psychological distress associated with joblessness and discouragement.

Job Search Discouragement and Attributions of Responsibility for Joblessness

Job search discouragement can be viewed as a complex social psychological phenomenon which is closely linked to attributions of responsibility or what people perceive as the causes of their job search failure.

Even the operational definition represented in governmental survey measures recognizes discouragement as essentially a social psychological state with a behavioral, cognitive, and affective component. Hence a jobless person is classified as discouraged when he/she does not actively search (behavioral) for a job because of a belief (cognitive) that such efforts will not yield a desired job (affective). Such reductions in the frequency of job search activity due to a belief that active search will not be rewarded with a job is readily predictable from "expectancy" theories of motivation, which stress the extent to which the motivation to action depends upon the expectation that the action will be positively rewarded. Some further predictions about the effects of job discouragement are suggested by the literature on "attribution" theories of achievement motivation—those theories which examine the consequences of the causal explanations that people attribute to events. These attribution theories suggest that a tendency to attribute job search failure to internal and stable factors—i.e., to factors such as low ability that are enduring qualities of the self—rather than external or unstable, transitory factors, may produce such behavioral, cognitive, and affective effects. Therefore, self-blaming attributions may 1) be closely linked to reductions in the frequency of job search, 2) produce an expectancy belief that job seeking efforts are futile and, 3) even reduce attraction to jobs.

In order to investigate the attributions associated with discouragement in job search, all jobless people whom we have defined as discouraged—i.e., all those who indicated that they had "lost hope that they can find a decent job"—were further asked why they felt that way. Those who had lost hope and stopped looking, as well as those who continued to look but had lost hope, were asked to explain the circumstances of their discouragement in greater detail. The open-ended responses varied from internal attributions emphasizing personal limitations to a focus on various external barriers such as job market limitations and lack of resources. As shown in Table 1 there are clear differences between discouraged jobless respondents who were still job searching and those who had stopped, in the proportions who made various kinds of causal attributions. Most striking is the clear tendency for those who had given up hope so much that they had stopped looking to blame themselves (personal limitations) much more than those who continued to look for a job. While the discouraged job seekers emphasized job market limitations, those who were no longer searching for a job tended to blame themselves. Also, those who had lost hope but continued to look for a job more often expressed frustration and emotional reactions to market limitations. Thus, a self-blaming attribution for job search failure was linked to the decision to stop looking, while continuing to search despite discouragement was more often associated with emotional reactions directed against external limitations and barriers.

Job Search Discouragement and Psychological Distress

The link between discouragement and psychological distress among people searching for a job and those not searching was explored by examining the relationship of job discouragement and job search activity to indices of life dissatisfaction, self esteem, personal powerlessness,

[3]The specific question asked of those who were looking for work was, "A lot of people would like to work but have lost hope that they can find a decent job. Do you feel that way?" Jobless respondents who were not looking for work were asked, "A lot of people have lost hope that they can find a decent job. Some lose hope so much that they stop looking for work. Is this true for you?"

TABLE 1. Relation of Search Activity Among the Discouraged To Attributions of Responsibility for Joblessness

Attributions for Joblessness	Discouraged, Not Searching for Jobs (N = 53)	Discouraged, Searching for Jobs (N = 58)
Personal Limitations Lack of skills, experience, age, health, etc.	46%	15%
Lack of Resources Transportation, contacts, money, etc.	2%	2%
Job Market Limitations No jobs available: race, sex or age discrimination	40%	55%
Emotional Reactions to Market Limitations Frustration, e.g., "getting tired of getting turned down"	12%	28%
Total	100%	100%

Missing Data are excluded from this table.

and psychosomatic distress. As Table 2 indicates, we found clear relationships between job search discouragement and each of the measures of psychological distress.

Since the measures of psychological distress were obtained from all respondents in the interview, Table 2 presents the findings for all jobless respondents, not just the discouraged workers whose attributional responses we compared in Table 1. Thus, Table 2 enables us to compare discouraged and not discouraged jobless workers, both among those who are searching for jobs and among those who are not searching. The findings in Table 2 indicate that, regardless of one's job search activity, the discouraged jobless respondents were clearly worse off psychologically than the non-discouraged. In both sets of comparisons of the discouraged and non-discouraged, the discouraged jobless respondents were clearly more likely to express distress on six of the seven measures: the discouraged respondents were more dissatisfied with their lives, had lower self esteem, had greater feelings of personal powerlessness, and more often had a physician-diagnosed "nervous" condition. In the fourteen comparisons between the discouraged and non-discouraged respondents presented in Table 2, there is only one instance where the discouraged group expressed *less* distress. On physician-diagnosed hypertension the discouraged workers not searching for a job were less distressed than those jobless non-searchers who were not discouraged. This latter group consists largely of homemakers, retirees, physically disabled, and students. The higher level of hypertension is due to the large number of older retirees in this particular group, most of whom are not considered part of the active labor force.

It is important to point out from the findings in Table 2 that the psychological distress which is a concomitant of job search discouragement occurs not only, as one might have expected, among those who have given up searching for jobs, but also among those who are still actively searching. This can be seen when we directly compare the two discouraged groups, those no longer job searching and those still searching (the first and third columns in Table 2). This comparison indicates that, except for diagnosed hypertension, the discouraged jobless who are still searching for a job are very similar in their high expressions of distress to those who have stopped searching. This is very

TABLE 2. Relation of Job Search Activity and Discouragement to Selected Indicators of Psychological Distress

Selected Indicators of Psychological Distress	Job Search Activity			
	Not Searching for Jobs		Searching for Jobs	
	Discouraged (N=53)	Not Discouraged (N=623)	Discouraged (N=58)	Not Discouraged (N=152)
Life Dissatisfaction "Somewhat" or "Very Dissatisfied" with my "life as a whole"	34%	19%	43%	32%
Self Esteem Feel that my life is not very useful	58%	35%	60%	36%
Do not feel that "I'm a person of worth"	50%	35%	54%	35%
Personal Powerlessness Feel that life is too much a matter of luck to plan ahead	65%	47%	69%	47%
Feel that problems of life are too big for me	52%	45%	59%	34%
Psychosomatic Distress Diagnosed "Nervous" condition	61%	42%	57%	32%
Diagnosed "Hypertension"	55%	61%	41%	37%

different from the findings from the comparison of the attributions of these two groups which we presented in Table 1, where we saw clear differences between the discouraged jobless who were still looking for work and those who had stopped looking. The findings in Table 2 suggest that discouraged jobless workers are psychologically at risk, even if they are still actively engaged in looking for work.

Conclusions

Our findings show that a significant portion of jobless black Americans in the national sample had become discouraged and stopped looking for a job. In addition, the number who continued to look although they had given up hope of finding a job was as large. An even greater number had a low expectation and considered it almost impossible to find the kind of job they were looking for. Such discouragement among those still looking for work suggests that they were potential labor force drop-outs.

The intriguing results showing that self-blaming attributions distinguish discouraged workers who had stopped looking for a job from the discouraged who continued to look are consistent with an attribution theory of achievement motivation. Past studies have found that motivation for a task such as job search is reduced if one makes self-blaming attributions to internal and stable sources such as lack of ability. This runs counter to some conceptions that view lack of personal responsibility as the core issue in problems of joblessness. Personal responsibility can be effective if it is tied to hope. It can be debilitating and demobilizing if it goes with hopelessness and leads to self-blame. Further research is needed to better clarify the role of attributional processes in the decision to stop looking for a job among discouraged workers.

The psychological distress associated with job search discouragement is likely to increase future economic marginality, political alienation, and social conflict within black communities. For example, we should consider the long term effects on black youth whose motivation for school achievement and work attitudes are being stifled by adverse emotional reactions to widespread job search discouragement. A sense of hopelessness, low educational attainment, and inadequate work experience may dampen the future prospects for increasing numbers of discouraged black youth. Such consequences of discouragement may leave many black teenagers ill prepared to compete for the types of jobs produced by reindustrialization and economic growth, even if the most optimistic long-term jobs forecasts are correct.

Although they have far reaching implications, questions concerning the broader economic, social, and political consequences of job search discouragement remain relatively unexplored. Are the strivings for upward mobility among discouraged black youth affected by the causal attributions they make about their job search failure? How do black adults who have given up hope of finding a job survive economically and provide for their families? Does discouragement motivate one's involvement in irregular economic exchanges of goods and services within local communities? Under what conditions might discouragement produce apathy or political consciousness? What factors determine the readiness of black discouraged workers to act on behalf of broader group causes rather than against community interests?

These questions have clear theoretical and social relevance. Basic social psychological inquiry on issues related to job search discouragement will increase in urgency if the severity of joblessness continues to grow among blacks and other groups as we move further into the 1980s.

Gender and Politics in the Eighties

Michael W. Traugott
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With increasing frequency the president of the United States and his policies are being discussed in terms of differential evaluations by men and women in the electorate. In the parlance of the popular press, we are witnessing the development of a "gender gap" in American politics for the first time since World War II; and this is causing many politicians and their advisors to pay particular attention to differences in the political attitudes of men and women. In terms of the only political currency which counts, women's attitudes have taken on special significance because they are voting in greater numbers than men.

Through the early post-war period, there were more male voters than female voters because of differences in their levels of education and occupational status. When adjustments were made for these factors, their turnout rates tended to be equal. During the 1960s and 1970s, as women joined the work force in increasing numbers and their levels of education rose, they generally became more active politically; and the absolute number of women voting increased until it surpassed the number of men. In 1980, for the first time the turnout rate for women equalled that for men; among the population under 45 years of age, the voter participation rate for women exceeded that for men.[1]

In that presidential campaign, national survey data showed that women and men were evaluating Jimmy Carter

Note: This analysis is based upon data collected by the Center for Political Studies for *The Detroit News* as part of their coverage of the 1982 election campaigns in Michigan. The analysis and interpretations presented here are those of the author and not *The Detroit News*. The research assistance of Julio Borquez is gratefully acknowledged.

[1]U.S. Bureau of the Census, Current Population Reports, Series P. 20, No. 370, *Voting and Registration in the Election of November 1980* (Washington, D.C.: U.S. Government Printing Office, 1982), p. 4.

and Ronald Reagan in characteristically different ways on many issues. Although Reagan was elected president by a large plurality, it was primarily due to the support of male voters. At that time the "gender gap" became a topic for political analysts, and ever since it has been a continuing concern of members of the administration. Among other things, the Republicans' dream of a political realignment is threatened by the desertion of women from the party. With midterm elections approaching that are frequently seen as a referendum on the president's policies during the previous two years, members of the administration are demonstrating increased sensitivity to women's issues and the attitudes of women. The White House has proposed new and simplified rules for claiming child care deductions from the federal income tax,[2] and presidential advisors have prepared an extensive briefing book on dealing with popular perceptions that the president lacks compassion.

Is all of this activity warranted on the basis of an empirically demonstrable need to take gender differences in political attitudes into account? And if this might be indicated at the national level, are there any consequences which can be anticipated for politcal candidates at the state and local level? Recent data collected by the Center for Political Studies suggest that the answer to both questions is "yes."

What is a Gender Gap and How Will I Know if I See One?

It is important, of course, to understand what the "gender gap" is and is not, beyond the fact that it is a popular phrase in current vogue which describes a particular form of group identification. It suggests that men and women will have characteristically different attitudes on some issues or attach differential significance to their attitudes on some issues. To a politician or a political scientist, it also suggests that they evaluate political figures (and conceivably political institutions) in these terms, and at least one consequence of this is that differential patterns of candidate support result.

The concept of a gender gap does not rely upon the notion that men and women differ in their attitudes on *every* issue. Nor does it presuppose that they always apply differential weights to specific issues or their perceptions of the policy positions of candidates on them. But it does imply that important and consistent differences between men and women can be observed on some issues, and that these differences are politically meaningful because they are related to voting behavior.

There is no doubt that a gender gap of this sort appeared during the 1980 presidential election and that it persists in evaluations of the Reagan presidency. A Harvard political scientist analyzing the 1980 American National Election Study conducted by the Center for Political Studies[3] has shown that men and women saw Reagan and Carter as different and that these differential assessments had an impact on the likelihood of voting for a candidate. In particular, men and women had different attitudes on three dimensions related to the use of force, social compassion, and women's issues. Knowing a voter's attitude and perception of differences between the candidates' stands on an issue was a powerful predictor of support. For both men and women, the probability of voting for Carter increased if the respondent favored the Equal Rights Amendment and he or she thought Carter did. It increased further if they thought Carter did and Reagan didn't. These increases in the likelihood of voting for Carter were much greater for women than men, supporting the notion of differential weights which they attached to the issue.

Since the Reagan inauguration, a number of national surveys have shown that women's concerns about his administration persist. The much greater cause for alarm among Republicans is an indication that women are defecting from the party as a result of this. While Republicans were aglow in early 1981 about the prospects of an enduring realignment in the basic distribution of partisan affiliation in the United States, they are presently concerned about maintaining their former levels of support.

Now that political candidates and activists have been sensitized to this set of issues in 1982 by the amount of coverage which they have received in the national press and the concern of the national parties, the question arises as to whether a similar gender gap exists in the evaluation of candidates for state and local office. The Center for Political Studies is currently engaged in an ongoing research project which suggests that it does and which is casting some light upon its dynamics in a general election campaign.

The 1982 Michigan Campaigns

There are two major statewide races currently under way in Michigan. Three-term Republican Governor William Milliken is not seeking reelection, and the vacant seat is being contested by Richard Headlee, a businessman who was a surprise winner in the Republican primary over Milliken's lieutenant governor, and James Blanchard, a Democratic congressman. Incumbent Democratic Senator Donald Riegle is attempting to return for a second term in a race with Philip Ruppe, a former congressman. Most of the attention has focused on the Governor's race because of the background and personality of the two main candidates and their opposing views on invigorating the state's economy and a number of women's issues.

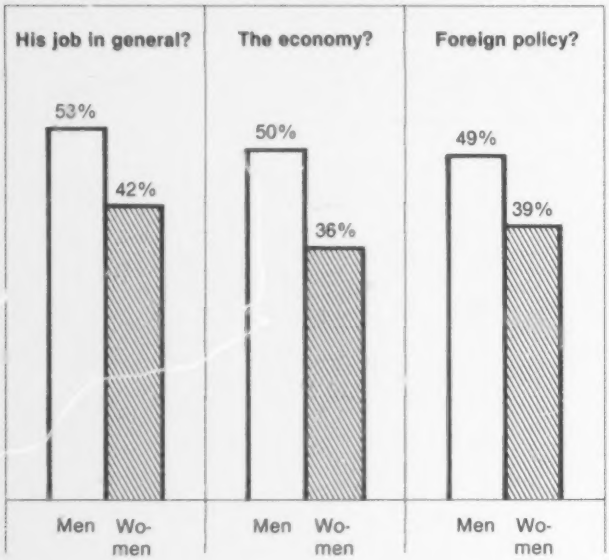
As of this writing, the Center for Political studies has completed two of three pre-election surveys for *The Detroit News* which are an important element of the newspaper's coverage of the campaign. The design of the study includes reinterviews with some respondents in order to measure changes in their assessments of candiates across the campaign. These data provide interesting and detailed information about the nature and extent of a gender gap in the Michigan electorate, increasing our understanding of how it develops and its potential consequences in American politics.

To begin with, the data collected in the first two surveys in August and September show that Michigan is a microcosm of the nation in terms of the existence of a gender gap in evaluations of President Reagan and with regard to a variety of political and social issues related to the use of force, compassion, and feminism. As the data in Chart 1 show, women are less likely than men to approve of Reagan's handling of his job in general, of the economy, or of foreign policy. Women are also more concerned that the prospects of war have increased in the past year (44% to

[2]"Reagan's 1040A Overture to Women," *Newsweek* (October 4, 1982), p. 19.

[3]Ethel Klein, *Why Women Rebel: The Rise of Contemporary Feminism* (Cambridge, Massachusetts: Harvard University Press, forthcoming).

CHART 1. Approval Ratings for President Reagan's Handling of . . .



30%), although they are no more likely to favor a nuclear freeze than men (69% to 68%).

When evaluating social programs, women are more likely than men to say that the state is spending too little on protecting public health, education, and solving the problems of the big cities. But there are no gender differences in attitudes toward spending on the environment or halting the rising crime rate.

In terms of three measures of attitudes on what many see as women's issues, there are no substantial differences between men and women in Michigan. They favor the Equal Rights Amendment at the same level (65%), and female respondents are only somewhat more likely than males to think that women have an equal role with men in running business, industry, and government (56% to 52%). A majority of men (55%) think it should be possible for a pregnant woman to go to a doctor to have an abortion if she is married and does not want any more children, while women are evenly divided (49% to 51%). When analyzed in relation to reported 1980 presidential vote, however, the greater weight that women attach to these issues is clearly demonstrated in relation to their preference.

Of even greater significance, the distribution of party identification in Michigan by sex has shifted slightly away from the Republicans since 1980, as it has at the national level. Chart 2 compares data from an October 1980 survey with those from August 1982. Party identification among men has remained about constant; the proportion of women identifying as Independents or with the Republican party has declined, and their Democratic identification has increased by about 10 percentage points.

These data show the clear existence of a gender gap in the Michigan electorate with regard to national political figures and issues. In terms of statewide races, the effects appear to be there as well and growing across the campaign. Men and women do not differ in their assessments of the most important problems facing the state—jobs and the economy. And they do not differ in their assessments of the candidates' ability to deal with them, particularly for governor, in any way that the candidates' positions and the respondents' party identification would otherwise have suggested.

But the weights which men and women attach to feminist issues are substantially different and explain why the Democrats have big leads in both races. These leads can be attributed in large part to disproportionate support from women. It is true that Headlee and Blanchard have diametrically opposed views on two important issues—abortion and the ERA—which serve to heighten the gender differences observed in the Michigan surveys. While they are analogous to the Reagan—Carter differences, these clear distinctions won't always be observed in other races in other states. But the survey shows in detail what can happen when they do.

Information is presented in Table 1 relating preference for the candidates to the attitudes of men and women on these three women's issues. In almost every case, Blanchard holds a lead over Headlee. Among men, there is no relationship between support or opposition to feminist issues and a preference for Blanchard, indicating it derives from other considerations. Among women, however, the story is quite different. In August there was a substantial difference in support for Blanchard among women who supported the ERA versus those who opposed it. But there was no difference based upon attitudes towards abortion or the position of women in society. By September, large differences had appeared on these issues as well. While Headlee has been holding his own among men in relation to these assessments, he has been losing ground rapidly among women.

There are a number of factors which might explain these shifts, all related to the stimuli of the campaign. One is the acceleration in the quantity of campaign activity by the

CHART 2. Shifts in Party Affiliation in Michigan, 1980–1982, by Sex of Respondent

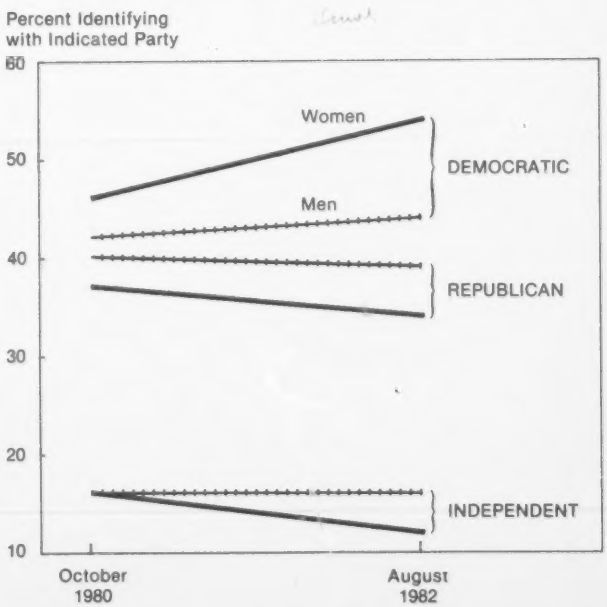


TABLE 1. Percentage Point Lead of Blanchard (Democrat) over Headlee (Republican) among Men and Women Interviewed in August and September 1982 by their Attitudes on Selected Issues

	Men		Women	
Issue	**August**	**September**	**August**	**September**
ERA[1]				
Favor	14	20	31	39
Oppose	17	15	2	0
Abortion[2]				
Favor	12	15	24	39
Oppose	10	16	20	20
Position of Women[3]				
Equal to men	6	16	20	34
Place in home	8	11	21	21

[1]"Do you favor or oppose the Equal Rights Amendment – also known as ERA – the proposed constitutional amendment concerning women?"

[2]"Do you think it should be possible for a pregnant woman to go to a doctor to have an abortion if she is married and does not want any more children?"

[3]"Some people feel women should have an equal role with men in running business, industry, and government. Suppose these people are at one end of a scale at point 1. Others feel a woman's place is in the home. Suppose these people are at the other end at point 7. And, of course, other people have opinions in between. . . . Where would you place yourself?" (Combined responses are 1–3 and 5–7.)

candidates since the August 10 primary. They are speaking out more, establishing higher levels of recognition, and making their own positions and their opponents' better known. Secondly, the quantity of press coverage has increased, highlighting the issue positions of the candidates. In particular, Martha Griffiths' selection as Democratic lieutenant governor has kept women's issues in the foreground. Thirdly, other political actors have made news, most notably the temporary defection of several Republican women to Blanchard, including the former state party chairperson. The net consequence of all of this is a relatively unambiguous message to women, particularly those who favor feminist positions, about whom to support.

It is worth noting that party identification plays a very interesting role in this entire process. Neither Democratic men nor Democratic women have any trouble in deciding whom to support – 9 out of 10 favor Blanchard. Republican women, especially those who favor abortion, are having a difficult time figuring out what to do. Only half support Headlee, while about equal proportions of the rest favor Blanchard, the independent candidate Robert Tisch, or remain undecided. Independent women favor Blanchard over Headlee by a 2 to 1 margin.

Conclusions

The notion of women identifying with each other as a group of individuals with particular interests is obviously no different from farmers, Democrats, or hunters and fishermen sharing a set of common interests and values. This does not imply that all of their interests and values are the same, nor must they be formally organized on the basis of their gender in order to represent a significant political force. In political terms, there is no denying that gender differences in voting are growing and taking on an increasing importance for candidates at all levels of office. One important consequence may be a lasting effect on the relative distribution of party strength in the United States because of the alienation of a new and politically active cohort of women.

Postscript, 12 November 1982

There are two inferences to draw with regard to gender and the outcome of the 1982 midterm elections – one in the nation as a whole and one in Michigan.

According to national "exit surveys" conducted with voters as they left the polls, the gender gap described above has now appeared in the voting patterns of men and women for House candidates. The New York Times/CBS News Poll reported that women were more likely to have voted for Democrats (56% to 40%) than men (53% to 43%). This difference was not apparent in the 1978 election when both groups favored Democrats by about the same amount, approximately 12 percentage points. (*The New York Times,* 8 November 1982.)

When sufficient time has passed for more intensive data analysis, it will probably be the case that the gender differences observed at the polls will be smaller than the differences in candidate evaluations which existed in the adult population as a whole. The final pre-election survey in Michigan, conducted in October, suggested that women were experiencing tremendous cross pressures between their party identification and their assessments of the gubernatorial candidates on social issues. This is likely to have manifested itself in reduced turnout rates among women. When estimates of the likelihood of voting were made for each respondent, Independent and moderate Republican women appeared to be the least likely to vote. There is some indication in "exit surveys" conducted by local television stations in Michigan that gender differences were present among voters, but not as strongly as indicated by pre-election surveys.

This will be an interesting behavior pattern to observe in future elections, with the distinct possibility that gender differences in voting will become somewhat larger and more prevalent as group identification among women increases.

Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Act'l.	Projected	
	1981:1	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1982:3	1982:4	1983:1	1983:2	1983:3	1981	1982	1983
GROSS NATIONAL PRODUCT	2,865	2,902	2,981	3,003	2,996	3,045	3,091	3,108	3,176	3,245	3,318	3,395	2,938	3,081	3,363
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	190.0	193.2	197.4	201.6	203.7	206.0	208.7	209.5	212.6	215.7	218.7	221.9	195.5	208.0	220.3
CORPORATE PROFITS AFTER TAXES	161.6	146.2	150.8	144.9	115.0	116.3	NA	119.5	127.4	127.0	128.5	133.5	150.9	119.0	133.0
UNEMPLOYMENT RATE (percent)	7.367	7.400	7.367	8.367	8.767	9.467	9.900	9.8	9.6	9.3	9.2	9.0	7.625	9.4	9.1
INDUSTRIAL PRODUCTION (index, 1967 = 100)	151.8	152.5	153.0	146.3	141.8	139.4	138.1	139.6	142.0	144.0	146.0	149.0	150.9	140.7	147.0
NEW PRIVATE HOUSING UNITS STARTED (millions)	1.399	1.173	0.962	0.865	0.920	0.952	1.114	1.054	1.120	1.190	1.300	1.300	1.100	1.020	1.300
CONSUMER PRICE INDEX (% change from prior quarter or year)	11.0	7.8	11.8	7.8	3.2	4.6	7.6	7.4	6.0	6.2	6.0	6.0	10.3	6.4	6.2
90-DAY TREASURY BILL RATE (%)	14.37	14.83	15.09	12.02	12.90	12.36	9.71	10.50	9.50	10.30	10.50	10.30	14.08	11.20	10.20
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	14.37	15.22	16.33	16.01	16.14	15.65	NA	14.80	14.30	14.10	13.80	13.50	15.48	15.20	13.50
GNP IN 1972 DOLLARS	1,508	1,502	1,510	1,490	1,471	1,478	1,481	1,483	1,495	1,506	1,517	1,532	1,503	1,481	1,525
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	951.1	944.6	951.4	943.4	949.1	955.0	958.4	963.0	972.0	978.0	983.0	991.5	947.6	960.0	988.1
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	169.7	170.1	173.9	174.2	172.0	166.7	161.0	162.0	158.0	158.0	159.1	162.0	172.0	165.0	161.0
RESIDENTIAL FIXED INVESTMENT (1972 $)	49.6	47.3	42.9	39.9	38.9	40.1	40.5	40.2	41.0	42.1	43.5	45.5	44.9	40.0	44.7
CHANGE IN BUSINESS INVENTORIES (1972 $)	2.4	12.1	16.5	4.8	-15.4	-4.4	0.7	-4.0	1.	3.0	4.0	6.0	9.0	-6.4	3.1
NET EXPORTS (1972 $)	48.2	44.2	39.2	36.5	36.9	35.7	30.7	34.7	33.5	33.9	33.8	33.5	42.0	35.2	33.7
FEDERAL GOVERNMENT PURCHASES (1972 $)	107.9	107.0	110.7	116.0	114.4	110.3	115.3	111.0	112.0	113.0	113.2	114.6	110.4	112.0	114.0
STATE & LOCAL GOVERNMENT PURCHASES (1972 $)	179.0	176.9	175.7	175.3	174.9	175.0	174.7	175.0	175.0	173.8	173.5	173.3	176.7	175.0	173.0

SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1979:4	1980:1	1980:2	1980:3	1980:4	1981:1	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1979	1980	1981
GROSS NATIONAL PRODUCT	2,503	2,576	2,573	2,644	2,739	2,865	2,902	2,981	3,003	2,996	3,045	3,091	2,418	2,633	2,938
PERSONAL CONSUMPTION EXPENDITURES	1,578	1,619	1,622	1,682	1,746	1,800	1,819	1,869	1,885	1,919	1,948	1,989	1,507	1,667	1,843
GROSS PRIVATE DOMESTIC INVESTMENT	416.8	424.0	391.0	384.1	410.3	455.7	475.5	486.0	468.9	414.8	431.5	438.5	423.0	402.3	471.5
NET EXPORTS	10.5	14.0	24.2	39.0	23.5	31.2	23.7	25.9	23.5	31.3	34.9	13.2	13.2	25.2	26.1
GOVERNMENT PURCHASES	497.6	519.2	536.0	538.5	559.8	578.1	583.2	600.2	626.3	630.1	630.9	650.2	474.4	538.4	597.0
DISPOSABLE PERSONAL INCOME	1,715	1,767	1,781	1,846	1,903	1,959	1,997	2,060	2,101	2,117	2,152	2,202	1,650	1,824	2,029
PERSONAL SAVING RATE (% of disposable income)	5.1	5.5	6.1	6.1	5.5	5.4	6.1	6.5	7.5	6.6	6.7	6.9	5.9	5.8	6.4

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late July, and projected data, released by ASA-NBER in September, are displayed for third quarter 1982.

Sources: Projections: American Statistical Association–National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

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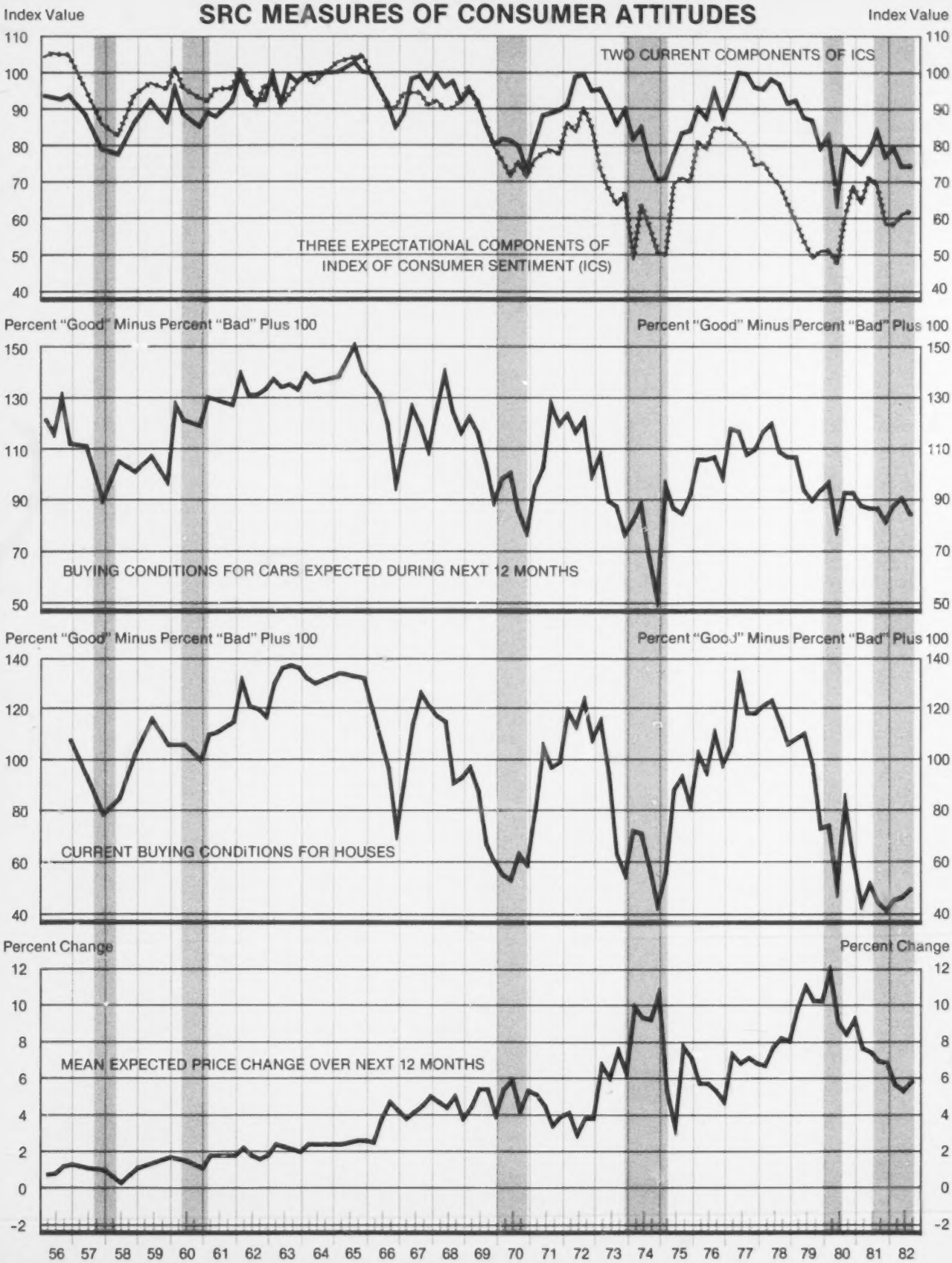
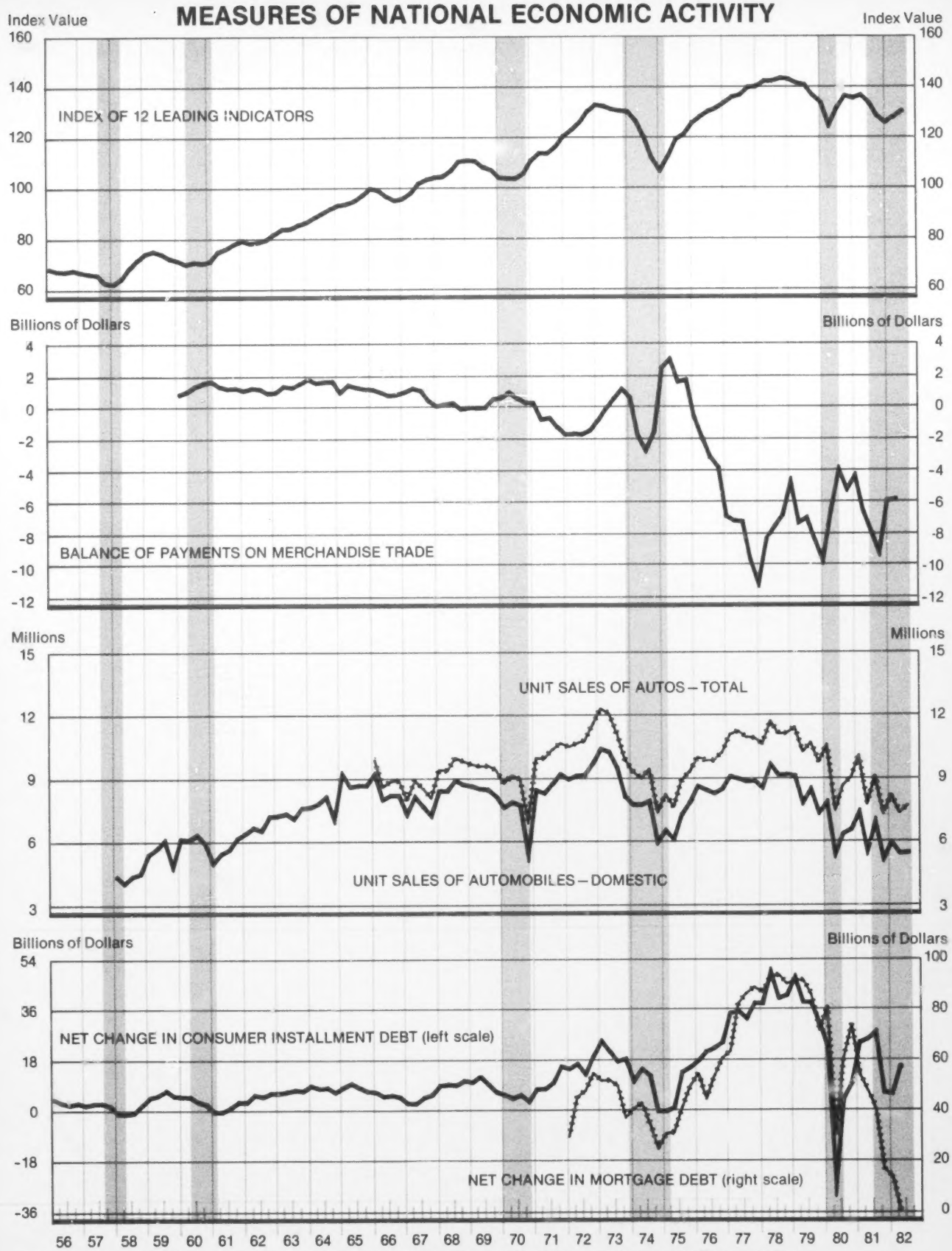
SRC MEASURES OF CONSUMER ATTITUDES


Index Value
Index Value
TWO CURRENT COMPONENTS OF ICS
THREE EXPECTATIONAL COMPONENTS OF INDEX OF CONSUMER SENTIMENT (ICS)
Percent "Good" Minus Percent "Bad" Plus 100
Percent "Good" Minus Percent "Bad" Plus 100
BUYING CONDITIONS FOR CARS EXPECTED DURING NEXT 12 MONTHS
Percent "Good" Minus Percent "Bad" Plus 100
Percent "Good" Minus Percent "Bad" Plus 100
CURRENT BUYING CONDITIONS FOR HOUSES
Percent Change
Percent Change
MEAN EXPECTED PRICE CHANGE OVER NEXT 12 MONTHS
56 57 58 59 60 61 62 63 64 65 66 67 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82

Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



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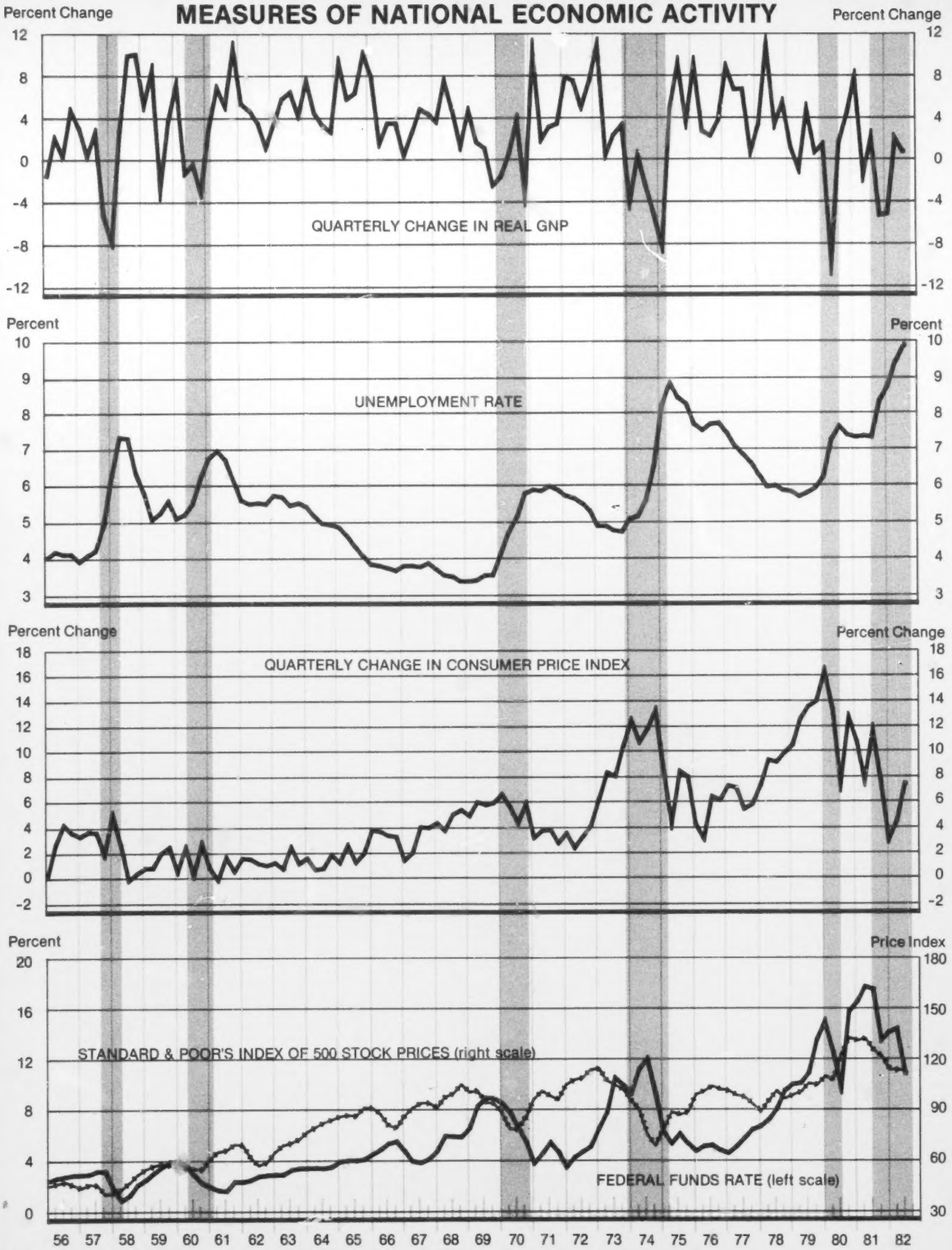

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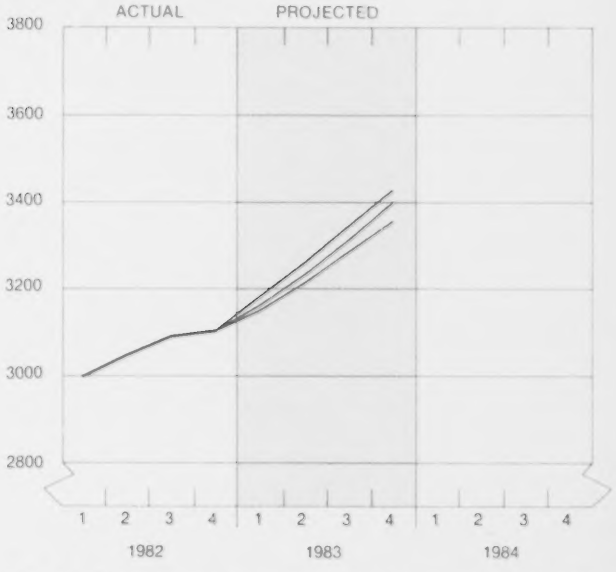
ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

GROSS NATIONAL PRODUCT

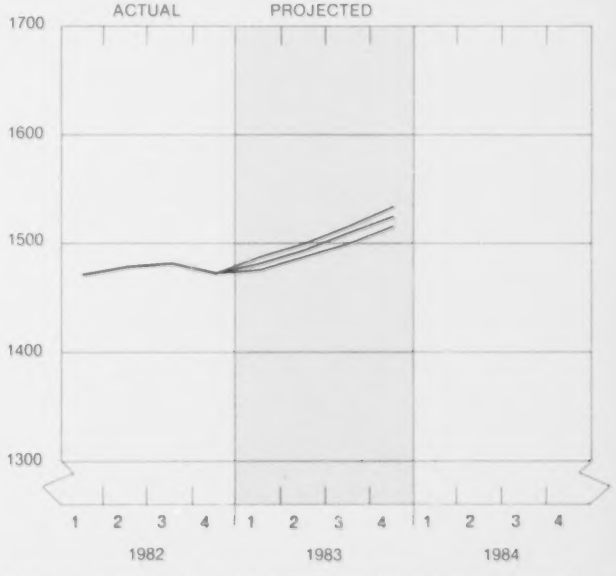
IN CURRENT DOLLARS
Billions of Dollars



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



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The U.S. Economic Outlook for 1983[1]

**Saul H. Hymans, Joan P. Crary,
and E. Philip Howrey
Department of Economics
The University of Michigan**

Review of the Forecast for 1982

Checking the past year's forecasting record[2] reminded us of the question that was so popular about eight year ago: how much did we know and when did we know it? We certainly understood a year ago that the economy was in a serious recession, and we were forecasting that real GNP would drop by nearly 5 percent (annual rate) in 1981:4. But we summarized the outlook a year ago as follows:

> The current recession will end early in 1982 after some inventory correction occurs and the recession itself produces an easing of credit conditions which the Fed accommodates.... Natural recovery forces—including strong underlying demand for housing...and autos—will lead the recovery in the spring and the mid-year personal tax cut will accelerate the recovery still further.

We expected real GNP to decline through the first quarter of 1982 and to rise thereafter. In that regard, we appear to have been correct. But in fact we had no inkling a year ago that the decline in 1982:1 would be about as severe as in 1981:4, or that the recovery during 1982:2 and 1982:3 would produce an increase in real GNP averaging only 1.4 percent per quarter at annual rate. If we use a GNP definition, the recession did end in the spring of this year, but the substantively important point is that these first two quarters of recovery have been the slowest and least satisfying on record, at least for the post World War II period. Indeed, the recovery has remained so uncharacteristically fragile and tentative that it is easy to deny that the recovery has yet begun in earnest.

The summary statement quoted earlier provides part of the key to understanding where we went wrong a year ago. We had expected a significant easing of credit conditions as the joint result of the recession itself and an accommodating monetary policy. We had forecast that short-term interest rates would drop by nearly five percentage points from 1981:3 to 1982:1, but the actual decline in short-term rates amounted to just over two percentage points, and short rates were actually rising between December and February. What we missed entirely was the nature of the money market's reaction to the realization that the Reagan administration and the 1981 Congress had produced a fundamental long-term imbalance in the federal budget. That fact was clear to the vast majority of economists at the time of the passage of the Economic Recovery Tax Act of 1981. We said so as strongly as we could in our forecast release of August 1981 when we predicted federal budget deficits of $100 and $135 billion for fiscal years 1982 and 1983, respectively. It took the money markets till about the end of last year to reject the patently ridiculous supply-side rhetoric and come to the realization that Reaganomics had greatly unbalanced the federal budget. The inescapable conclusion was that persistently high federal deficits would lead to high interest rates in the future—either because of rapid growth and intense competition between private and governmental credit demands, or because of a tight money policy in the face of an inflationary fiscal policy. And it didn't matter which. The expectation of high interest rates in the future kept current long rates very high, especially by the normal standards of a recessionary period. This drove existing credit demands into the short end of the market and put upward pressure on short-term interest rates. Judging by the monetary base, unborrowed reserves, and the discount rate, the Federal Reserve System was easing up in late '81 and early '82, but the Fed was unwilling or, in any event, did not manage to ease up by nearly enough to counteract the effects of the drastic revision in money market expectations.

It is our view that the continued sharp decline of the economy in the first quarter of this year, and the bare recovery since then, can be traced directly and fundamentally to the effects which the fiscal policy enacted in 1981 had on interest rates, and to the severe harm thereby imposed on the interest-sensitive sectors of the economy—especially the automobile and housing markets.

The Current State of the Economy

Despite an unemployment rate of 10.4 percent, consumer purchasing power (real disposable income) is the highest it has ever been; and even on a per-capita basis real disposable income is at a record high level. Consumer debt is low relative to income and consumer liquidity is high—in part because recent tax cuts have transferred liquidity from the federal government to the private sector. Short-term interest rates have declined by more than 5 percentage points since the summer and long rates by more than 3 percentage points. The prime rate, mortgage rates, auto loan rates, and consumer loan rates in general are all moving downward.

The marked reduction in interest rates is very likely to remain in effect for at least several months. The real break in interest rates came in late July and early August when it became increasingly clear that Congress—led by the Senate—was prepared to pass a multi-year $100 billion tax increase bill even if it had to force it on the administration. When accomplished—with the president ultimately joining in favor of the bill—this marked a significant, though not yet sufficient, change in the course of fiscal policy. For a while, at least, the tax increase bill has seemed to allay fears about grossly unmanageable out-year budget deficits. Further, since the time of the tax increase the Federal Reserve has been more accommodative in terms of policy actions and even in terms of public statements of intent.

In this context in which purchasing power and credit conditions are *both* favorable to expansion, we are con-

[1]This is an abridged version of the authors' presentation to the 30th annual Conference on the Economic Outlook at The University of Michigan.

[2]The November 1981 RSQE forecast suggested that real GNP would increase by about $17 billion in calendar year 1982, while it actually declined by about $27 billion (both amounts in 1972 dollars).

vinced that the economic recovery will strengthen and that a modest gain in real GNP of 1½ percent at annual rate in the closing quarter of this year will be followed by a gain of about 3 percent in the opening quarter of 1983. Our view of the current state of the economy is consistent with the tone of our earlier discussion of the 1981–82 recession; i.e., that the economy has not been expanding at all satisfactorily since the spring, surely not rapidly enough to keep unemployment from rising, and that many sectors of the economy have remained seriously depressed.

Before going on to present our forecast in detail, we turn to a discussion of the major input assumptions which form the basic context for our forecast of economic developments during the coming two years.

Inputs to the Forecast

The *federal tax program* embodied in our forecast is the net result of the Economic Recovery Tax Act of 1981 and the Tax Equity and Fiscal Responsibility Act of 1982. Thus the third stage of the 5-10-10 personal tax cut program is assumed to reduce federal personal income tax rates by 10 percent—or about $30 billion at annual rate—effective July 1, 1983. This is partially offset by a series of personal tax increases and tax enforcement provisions emanating from the 1982 act which will yield about $8½ billion in revenue for fiscal 1983 and more than $12 billion in fiscal 1984. In addition, the 1982 act raises excise taxes by about $2½ billion in fiscal '83 and $3.8 billion in fiscal '84. Revenues from business taxes are increased by about $10 billion in fiscal '83 and $18½ billion in fiscal '84 as a result of the increase in unemployment taxes contained in the 1982 act and a number of revisions to business tax cut provisions originally contained in the 1981 tax act.

Our assumptions regarding *federal expenditures* in fiscal years 1983 and 1984 are shown in Table 1. Total federal expenditures (NIPA basis) are projected to increase by about $54 billion and $41 billion in fiscal '83 and '84 respectively, compared with an increase of nearly $75 billion in fiscal '82. Our projected increase of $54 billion for fiscal '83 compares with a $46 billion increase in NIPA expenditures originally projected by the Commerce Department's 1983 Budget Translation in February of this year and the Congressional Budget Office's September projection of a $55 billion increase in Unified Budget expenditures. A major reason for the smaller spending increase which we are projecting for fiscal '84 is the reduction in unemployment benefit payments implied by our forecast. The principal assumptions underlying the exogenous components of our expenditure totals are

- *10 percent annual increases in defense spending* in each of the next two fiscal years, exclusive of pay increases, and
- *continued reductions* in a number of discretionary civilian expenditure programs, including grants-in-aid and various transfer and subsidy programs.

The net result of our budget assumptions and our economic forecast is the bottom line in Table 1: *a federal deficit* amounting to $143 billion for fiscal year 1983 and $105 billion for fiscal 1984.

It is apparent that the Federal Reserve Board began late last year to conduct an easier monetary policy than that which had been pursued during most of 1981, and since late summer of this year the Fed has eased up a great deal more. It is our perception that this most recent move in monetary policy is based on three factors. First, the tax increase bill passed in August permitted an exchange of a somewhat easier monetary policy for the somewhat tighter fiscal policy. Second, the combination of a depressed economy and a much more favorable inflation outlook constituted a strong argument for an easing of credit conditions to which the Fed appears to have responded. And finally, international financial conditions provided a third reason to favor lower interest rates. By some estimates there may be about $300 billion in Third World debt at risk—much of it representing liabilities of Third World countries to banks in the U. S., Western Europe, and Japan. Much of this debt involves interest payments sufficiently burdensome to be causing substantial international payment imbalances and increasing risk of default for a number of countries. It appears that the central banks of the major OECD countries, including the U. S., are actively attempting to bring interest rates down in order to restructure some of these debts so as to involve substantially lower interest payments and thereby ease the evident strains in the international money markets.

Based on these factors, we have made the following specific *assumptions regarding monetary policy:*

- *The discount rate* will be reduced to 8 percent by mid-December, most likely in a series of half-point steps several weeks apart.
- *The monetary base* will be allowed to grow at an annual rate of 7 percent in the current quarter and will then be reduced to a growth rate of 6 percent during 1983 and 1984.

In the context of our forecast these assumptions imply that the 90 day treasury bill rate will bottom out at about 6½ percent in 1983:1, rise to just over 7 percent by the fall of next year, and remain at about that level for the balance of the forecast period. M1, adjusted to include savings accounts, would in this context grow at an average annual

TABLE 1. Federal Government Expenditures and Receipts (National Income and Product Accounts, billions of dollars)

Expenditures, Receipts, and Deficit	Fiscal 1982[1]	Fiscal 1983[2]	Fiscal 1984[2]
Total Expenditures	740.9	795.0	835.7
Purchases of Goods and Services	250.5	268.5	294.0
National Defense	173.2	194.3	217.7
Nondefense	77.3	74.2	76.3
Transfer Payments	310.9	339.6	349.2
Grants-in-Aid to State and Local Governments	84.0	77.7	73.2
Net Interest Paid	82.6	100.2	113.7
Subsidies less Current Surplus of Gov't. Enterprises	12.9	9.0	5.6
Total Receipts	617.0[3]	651.9	730.2
Deficit (-)	-123.9	-143.1	-105.5

[1]Data for Fiscal 1982 are from the *Survey of Current Business*, October 1982.
[2]RSQE projections and forecasts for fiscal years 1983 and 1984.
[3]Receipts and Deficit for 1982:3 are RSQE Projections.

rate of 10 percent from 1982:3 to 1983:3 and at a 7½ percent rate from 1983:3 to 1984:3.

We have made the following assumptions regarding *crude materials and food prices:*

- *Crude oil prices* will continue to weaken over the next several months and are then expected to rise at a rate of 4½ percent from spring '83 to spring '84.
- The *price of natural gas* is expected to rise by 15 percent during 1983 and by 10 percent during 1984.
- Benefitting from excellent harvest prospects and large carry-over stocks of grains, *food prices* are expected to rise by less than 5 percent during 1983 and by 6 percent during 1984.

Finally, we note our assumptions regarding *international trade* and the value of the U. S. dollar. From December of 1980 to August of 1981 our trade-weighted exchange rate rose by nearly 23 percent—equivalent to 36 percent at annual rate. When U. S. interest rates eased at the start of the 1981-82 recession, the dollar declined (on a trade-weighted basis) by more than 6 percent from August to December of last year. When U. S. interest rates spiked up again in the beginning of 1982 and then remained high till mid-summer, the dollar rose again; and by July of this year our exchange rate had risen by 13 percent relative to last December. Most recently, the dollar has remained strong against other Western currencies despite the sharp reduction in U. S. interest rates. Apparently, this reflects continued weakness in other Western economies, fears about Third World debt problems, and a nearly concurrent movement of U. S. and foreign interest rates. Most experts to whom we have spoken seem convinced that the U. S. dollar will not deteriorate relative to other major currencies in the near term. With relative economic weakness continuing to be the rule among our major trading partners, this implies a weak pattern of U. S. exports and a deterioration in our net export balance. We have assumed that real exports will grow at an average annual rate of only 1½ percent during 1983. For 1984 we are assuming a more rapid growth of real exports—about 2½-3 percent—as other Western economies and their currencies recover.

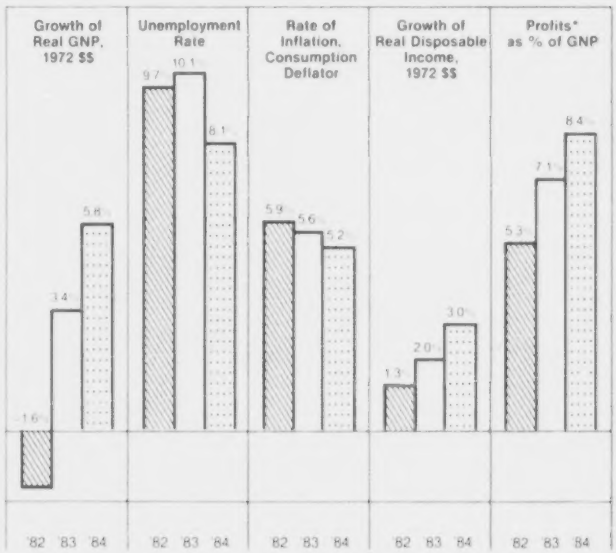
Overview of the Forecast

The RSQE forecast for 1983-84 is summarized in Chart 1. Based on the initial conditions and input assumptions already discussed, our econometric model forecasts an accelerating recovery from the 1981-82 recession such that real gross national product rises by 3.4 percent for the year 1983 and by 5.8 percent for 1984. Given our present estimate that real GNP will average 1,479 billion 1972 dollars for 1982, this implies real GNP levels of $1,530 billion and $1,619 billion for 1983 and 1984, respectively.

A growth of total output of 3.4 percent for 1983 would imply an unemployment rate averaging 10.1 percent next year—up from the 9.7 percent average for this year, but well below the 10¾ percent level expected to be reached before the unemployment rate begins to decline. The unemployment rate for 1984 is forecast to decline to 8.1 percent average as a result of the far larger output growth expected for that year.

In calendar year terms, our forecast implies continued moderation of inflation in 1983 and 1984. As measured by the personal consumption deflator, consumer prices in 1982 are expected to be 5.9 percent higher than in 1981 and to be up an additional 5.6 percent next year and 5.2 percent

CHART 1. Overview of RSQE Forecast for 1983-84



*Includes inventory valuation and capital consumption adjustments.

the year after. Our assumption of modest increases in food and oil prices contributes to this favorable inflation outlook. In addition, the combination of a moderate increase in hourly compensation—6.2 percent in 1983 compared with 7.2 percent in 1982—and a 3.8 percent gain in productivity—of which at least 2 percentage points are an economic recovery "bonus"—will restrict the growth of unit labor costs to only 2.3 percent for 1983.

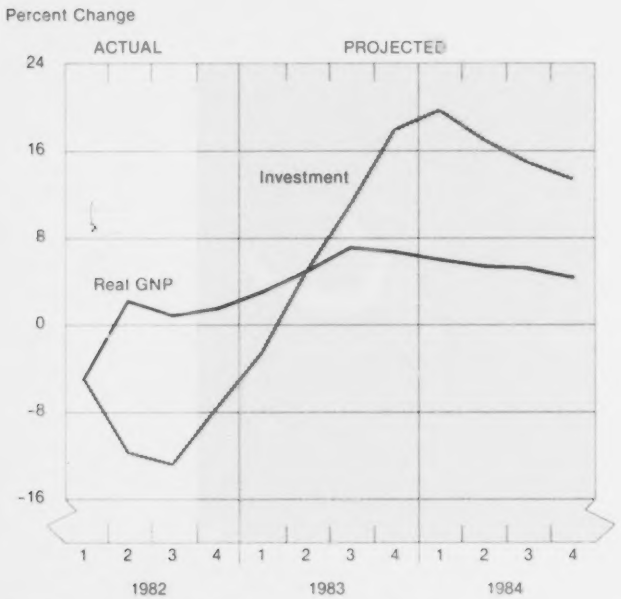
The combination of declining profit margins and falling production dropped the level of profits substantially in 1982, and the share of profits in GNP is expected to average just 5.3 percent this year—the lowest profit share of the entire postwar period, below the 6.6 percent share in the recession year 1974, and well below the share levels of 8-9 percent which characterized the late 1970s. The economic recovery forecast for 1983-84 will produce a substantial rise in the profit share of GNP—both because of higher levels of production and a recovery in profit margins. For 1984 we are expecting the share of profits in GNP to be up to 8.4 percent—much higher than this year, and about on a par with the levels reached in the late 1970s.

Consumer purchasing power will of course benefit substantially from, and contribute to, the economic expansion forecast for the next two years, with real disposable income rising by about 2 percent in 1983 and 3 percent in 1984.

The Path of Economic Recovery and Expansion

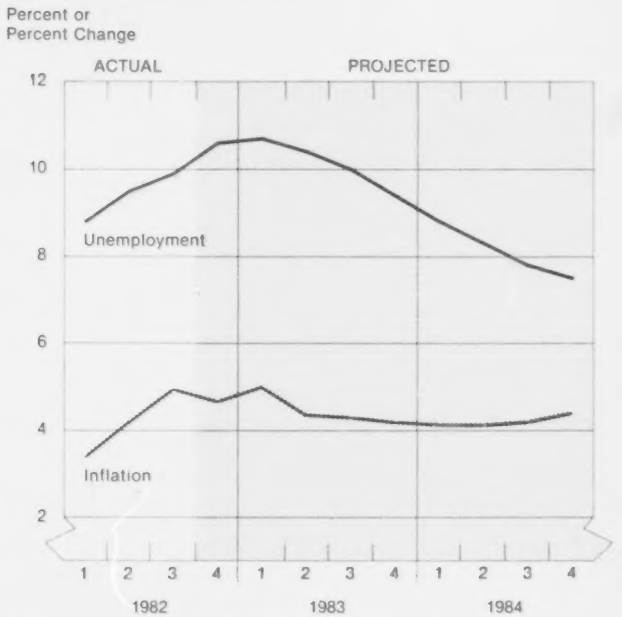
The forecast paths of a number of important indicators of macroeconomic activity are described in Charts 2-5. Chart 2 begins with the forecasts for the growth of real GNP and business fixed investment. Output growth is forecast to accelerate from 1.5 percent at annual rate in the current quarter to a peak of 7 percent in 1983:3. The rate

CHART 2. Annual Rates of Growth of Real Gross National Product and Business Fixed Investment (1972 dollars)



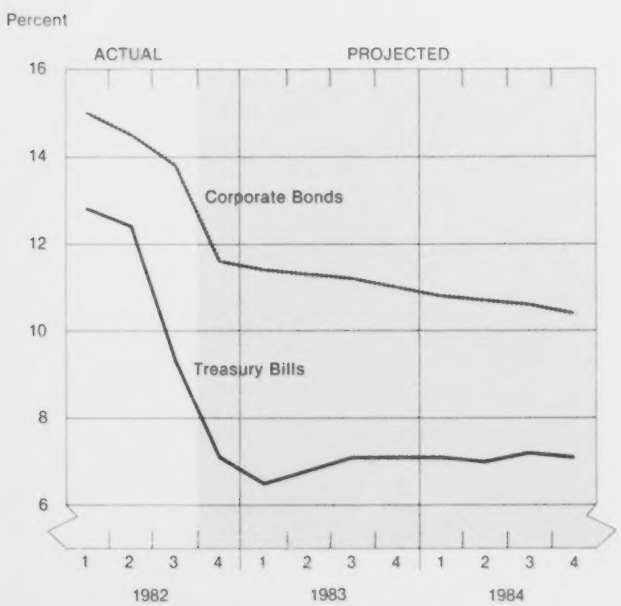
Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 3. Unemployment Rate and Annualized Inflation Rate (Private Nonfarm Price Deflator)



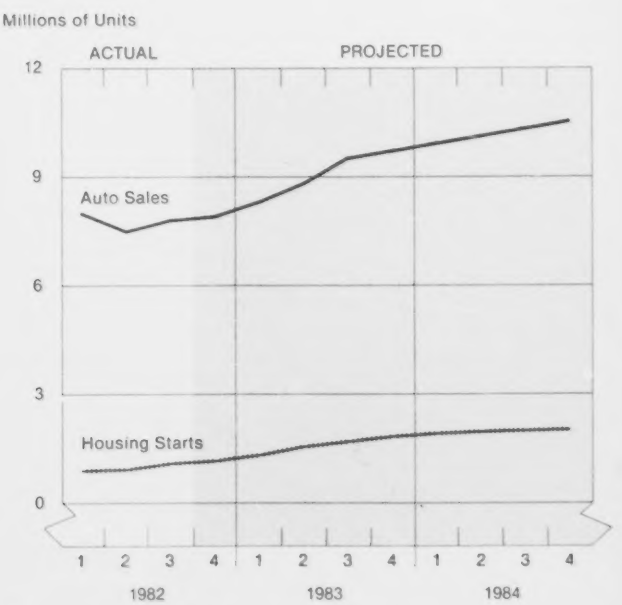
Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 4. Interest Rates for 3-Month Treasury Bills and Corporate Aaa Bonds



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 5. Automobile Sales and New Private Housing Starts



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

of growth of total output decelerates thereafter, reaching 5.3 percent in 1984:2 and 4.4 percent in the closing quarter of 1984. Corresponding to this output path is an unemployment rate (Chart 3) which peaks at a quarterly average of 10.7 percent in 1983:1, declines to about 9½ percent in 1983:4, and falls another two percentage points during 1984 to end that year at about 7½ percent—about the level from which the 1981–82 recession began.

Chart 4 summarizes our forecast of interest rates by plotting the 3-month treasury bill rate and the corporate Aaa rate. The treasury bill rate reaches a minimum quarterly average of 6½ percent in 1983:1, rises to about 7.1 percent in the fall of 1983, and then remains at that level for the balance of the forecast horizon.

In this connection, it should be noted that the federal deficit in our forecast declines from an annual rate of about $163 billion in the current quarter to about $125 billion in 1983:2, it rises to about $140 billion when personal tax rates are cut in 1983:3, and then it declines to about $110 billion by 1984:1 and to $83 billion by the last quarter of 1984. Thus as the economy grows over the next two years, the federal government's financing requirements will be making a progressively smaller call on the bond market.

The corporate Aaa interest rate, representative of long-term rates in general, is forecast to move downward from its recent level of 12 percent to about 11 percent by the fall of 1983 and to 10½ percent a year later.

The recovery and subsequent expansion in our forecast depend on the combination of recent gains in income and continued declines in borrowing costs inducing substantial improvements in both the automobile and housing markets—both of which have already begun to recover from their low points in the recession. Total new car sales—which averaged 7¾ million units at annual rate in 1982:3—are forecast to average just over 7.9 million units in the current quarter, 8.3 million units in 1983:1, and to continue up to a sales rate of about 10.5 million units at the end of 1984, as shown in Chart 5. These figures imply 9.1 million car sales for the calendar year 1983 and 10.2 million for calendar 1984, compared with sales of only 7.8 million cars this year.

Private housing starts are forecast to increase from about 1.2 million units at annual rate in the current quarter to 1.5 million by mid-1983, to 1.8 million by 1983:4, and to 2 million by the end of 1984. For 1983 as a whole, private housing starts are expected to be 1,618 thousand, up from 1,043 thousand in 1982.

We are expecting that business fixed investment will continue to decline in real terms during this quarter and the first quarter of next year (Chart 2). Business investment is forecast to begin to increase in 1983:2 and to accelerate over the following year, with the annual rate of growth of investment reaching a peak of about 19½ percent in the beginning of 1984. Capital formation will continue to rise all during 1984, but the *rate* of increase is expected to diminish as the year progresses.

Other important aspects of the 1983–84 expansion may be summarized as follows:

- The hourly compensation rate in the private nonfarm sector of the economy is expected to rise by 5.9 percent from the end of this year to the end of next year and by 6.3 percent during the following year as the rate of unemployment continues to decrease.
- The rate of inflation in the private nonfarm sector is expected to bottom out at 4.1 percent in the first half of 1984 and to rise to about 4½ percent by the end of 1984 as wage gains increase, the cyclical productivity bonus diminishes, and markets begin to tighten (Chart 3).
- The personal saving rate rose to 7.5 percent in 1981:4, the quarter in which the first installment of the 5-10-10 personal tax cut took place. It declined to 6.7 percent in 1982:2 and then rose to 6.9 percent when taxes were cut again the next quarter. In our forecast, the saving rate declines to 5.1 percent in 1983:2, jumps to 5.9 percent when the final stage of the tax cut occurs in 1983:3, and then declines again to reach and remain at 5.1 percent during the last three quarters of 1984.

Additional quarterly detail from the RSQE forecast is displayed in Table 2.

The 1983–84 Expansion in Historical Perspective

Having described the main elements of the economic expansion being forecast for 1983–84, we would now like to compare the projected expansion to those which occurred following the recessions of 1957–58 and 1974–75. The comparison is made in terms of four variables: real GNP, the unemployment rate, real business fixed investment, and the sum of consumer durables purchases and residential construction spending (both in real terms).

Each panel of Chart 6 deals with a single variable, comparing its behavior during and immediately following each of the recessions in question. In each panel a variable is plotted as a ratio to its value during the quarter in which real GNP reaches its cyclical trough, and the variable is shown for 5 quarters prior to the GNP trough quarter through 8 quarters following the trough quarter.

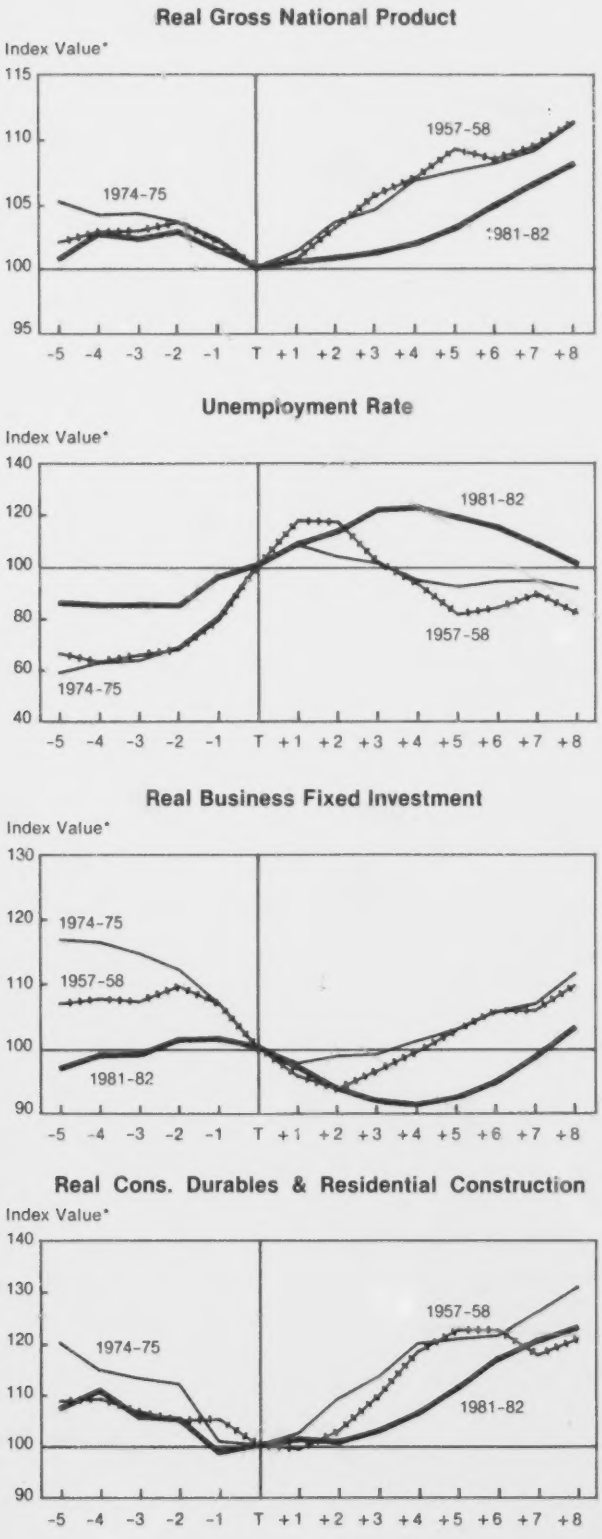
The behavior of real GNP is shown in the upper panel of Chart 6. Three points emerge from this chart. Looking first at the quarters approaching the trough in GNP, the substantial similarity of the 1957–58 and 1981–82 recessions stands out. Second, it is quite clear that as regards the first year of recovery following the GNP trough, the current episode is extremely unusual. The lethargic pace of GNP growth from 1982:1 to 1983:1 puts the current recovery well behind its predecessors. The third point is that the expansion being forecast for the period following early 1983 is characterized by a trajectory very similar to those which followed the troughs of the earlier recessions.

The unemployment rate shown in the second panel of Chart 6 tells a similar story, perhaps even more dramatically. In the prior recoveries, the unemployment rate peaked one quarter following the GNP trough; in the current instance it peaks one full *year* following the GNP trough.

The third panel of the chart displays the paths of real business fixed investment. Again recovery in the current episode features a considerably longer lag following the GNP trough, but once investment does turn up, its projected rate of increase is entirely consistent with those experienced in the earlier recoveries.

The final panel of Chart 6 plots the paths of consumer durables including residential building. In this case the current recovery lag is evident, but not quite as pronounced as in the case of business investment or GNP itself.

CHART 6. Comparisons of Economic Recoveries, Fifth Quarter before to Eighth Quarter after Cyclical Trough



*GNP trough quarter equals 100.

The point to be made about these comparisons is that the uniqueness of 1981–82 resides in the three or four quarters following the GNP trough. In essence, we have already dealt with this in our earlier discussion of the relation between the federal deficit, money market expectations, and interest rates. If that episode—and the grave fiscal policy error which gave rise to it—is truly behind us, then the economy is poised for a rate of economic recovery which is broadly similar to those which followed the severe contractions of 1957–58 and 1974–75.

Concluding Comments

We need hardly stress the degree of uncertainty which accompanies any current macroeconometric forecast. A number of the sources of possible disturbance are evident, and it is important to recognize them explicitly. A protracted period of high and rising unemployment not only reduces the purchasing power of those directly affected, it can also induce a concern about potential unemployment among those still employed. Have we crossed a threshhold in this regard? Are we now in a collective frame of mind which will generate unusually little consumer buying in relation to available purchasing power? Our late colleague Professor Katona, whose productive career concentrated on matters of this sort, continually stressed that consumer spending was the joint result of ability to buy and willingness to buy. The private sector's ability to buy is clearly enormous, despite the recession and high unemployment. The evidence contained in the latest consumer sentiment studies by the University's Survey Research Center are *in*consistent with the view that willingness to buy is deteriorating. The overall index of Consumer Sentiment registered values in the range of 73 to 77 index points just prior to the 1981–82 recession, then declined by about 10 points to remain locked at about 65 from April through August of this year. In September the Index jumped above 69 and in October it rose sharply to 73.4—the highest value in more than a year. Similar evidence is contained in that portion of the Index referring to families with incomes over $25,000. For this group the Index now stands at about 81 index points compared with values as low as 68 earlier in the year and peak values of 85 just prior to the recession. We can in no sense rule out the possibility of exceptionally low spending/income ratios, but the expectational evidence which *is* available would point toward more normal behavior in this regard.

Our forecast does not depend on business capital spending to initiate the acceleration of the recovery. If the consumer and housing sectors behave as we have forecast for the late '82 and early '83 periods, the subsequent recovery we have forecast for capital expenditure will be justified.

What we judge to be the greatest risk in the forecast is lodged in the federal government sector. We continue to hear reports from Washington—lately even from the president's advisers—to the effect that the 1984 budget could be well over $150 billion and perhaps nearer to $180 billion in deficit. Our forecast shows a deficit of $105 billion for fiscal '84 and, more important than the exact number, a significant *reduction* of the deficit in comparison with fiscal '83. There can be little doubt that both Federal Reserve policy and behavior in the money markets will depend heavily on what beliefs come to be dominant regarding the

TABLE 2. Selected Economic Indicators as Forecast by RSQE

Seasonally adjusted

ECONOMIC INDICATOR	Quarterly Data										Annual Data			
	ACT.	PROJECTED									PROJECTED			
													% Changes	
	82:3	82:4	83:1	83:2	83:3	83:4	84:1	84:2	84:3	84:4	1983	1984	82-83	83-84
GROSS NATIONAL PRODUCT	3,091	3,152	3,218	3,300	3,401	3,504	3,600	3,691	3,781	3,874	3,356	3,736	9.3	11.3
PERSONAL CONSUMPTION EXPENDITURES	1,990	2,033	2,076	2,121	2,177	2,225	2,271	2,318	2,367	2,417	2,150	2,343	9.0	9.0
DURABLE GOODS	240.7	246.6	253.2	262.1	274.2	281.6	287.9	294.2	300.7	306.5	267.8	297.4	10.9	11.0
AUTOMOBILES and PARTS	104.3	108.1	113.3	120.4	129.4	134.3	138.3	142.2	146.2	149.6	124.4	144.1	18.8	15.8
FURNITURE and H.H. EQUIPMENT	92.7	93.6	94.4	95.5	97.3	99.0	100.6	102.1	103.6	105.0	96.5	102.8	4.2	6.5
OTHER DURABLES	43.7	44.9	45.5	46.2	47.5	48.3	49.1	49.9	50.9	51.9	46.9	50.5	6.3	7.6
NONDURABLE GOODS	770.9	783.9	796.1	807.9	825.1	839.8	854.1	868.6	884.7	900.9	817.2	877.0	6.9	7.3
SERVICES	977.8	1,003	1,027	1,051	1,078	1,103	1,129	1,155	1,182	1,209	1,065	1,169	10.2	9.7
GROSS PRIVATE DOMESTIC INVESTMENT	438.5	440.2	454.0	481.1	516.6	557.6	596.9	631.5	661.8	689.5	502.3	644.9	16.5	28.4
NONRESIDENTIAL	341.6	338.2	339.9	348.0	361.5	380.7	402.2	422.7	442.4	461.8	357.5	432.2	3.0	20.9
RESIDENTIAL STRUCTURES	97.4	102.6	113.4	128.2	142.8	154.8	164.0	171.3	177.2	181.8	134.8	173.6	38.6	28.8
CHANGE in BUSINESS INVENTORIES	-0.5	-0.6	0.7	4.9	12.3	22.1	30.8	37.5	42.2	45.9	10.0	39.1	–	–
NET EXPORTS	13.1	14.0	13.5	11.5	7.5	1.4	-5.6	-13.4	-21.3	-28.8	8.5	-17.3	–	–
EXPORTS	356.6	358.0	361.9	366.4	371.8	377.7	384.2	390.9	398.4	406.2	369.5	394.9	2.6	6.9
IMPORTS	343.4	344.0	348.4	354.9	364.3	376.3	389.8	404.3	419.7	435.0	361.0	412.2	7.2	14.2
GOVERNMENT PURCHASES	650.2	664.3	674.5	686.5	699.0	720.7	737.6	755.0	773.8	796.7	695.2	765.8	8.0	10.2
FEDERAL	257.6	264.7	266.9	269.9	272.4	284.1	290.5	297.1	304.3	315.4	273.3	301.8	7.6	10.4
NATIONAL DEFENSE	183.7	190.2	192.9	195.7	198.4	208.5	214.6	220.8	226.9	235.3	198.9	224.4	11.1	12.8
OTHER	73.9	74.5	74.0	74.2	74.0	75.6	75.9	76.3	77.4	80.1	74.4	77.4	-0.8	4.0
STATE and LOCAL	392.6	399.6	407.6	416.6	426.6	436.6	447.1	457.9	469.5	481.3	421.9	464.0	8.2	10.0
GROSS NATIONAL PRODUCT DEFLATOR, 1972 = 100	208.7	212.0	214.9	217.8	220.6	223.8	226.6	229.3	232.1	235.2	219.3	230.8	5.6	5.2
REAL GROSS NATIONAL PRODUCT (billions of 1972 dollars)	1,481	1,487	1,497	1,515	1,541	1,566	1,589	1,609	1,630	1,647	1,530	1,619	3.4	5.8
AGGREGATE UNEMPLOYMENT RATE (percent)	9.9	10.6	10.7	10.4	10.0	9.5	8.8	8.3	7.9	7.5	10.1	8.1	–	–
CORPORATE PROFITS plus IVA and CCA	162.0	179.8	198.5	224.3	253.5	278.3	297.0	311.4	321.7	328.5	238.6	314.6	45.9	31.9
90-DAY TREASURY BILL RATE	9.32	7.12	6.50	6.77	7.10	7.10	7.08	7.02	7.19	7.12	6.87	7.10	–	–
REAL DISPOSABLE INCOME (billions of 1972 dollars)	1,061	1,064	1,063	1,064	1,087	1,094	1,099	1,104	1,115	1,123	1,077	1,110	2.0	3.1
PERSONAL SAVING RATE (percent of disposable income)	6.9	6.5	5.8	5.1	5.9	5.6	5.3	5.0	5.1	5.1	5.6	5.1	–	–

Note: All data are in billions of current dollars unless otherwise indicated.

Sources: Projections by Research Seminar in Quantitative Economics, University of Michigan; actual data from Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

path of the deficit and the economic conditions which accompany the deficit. Perhaps the pundits in Washington know a great deal more about actual expenditure plans than we do, perhaps there's a scare campaign under way to insure that the budget really is brought under control, and perhaps it's a good bit of each. What is absolutely certain is that the federal budget cannot remain fundamentally imbalanced without sooner or later causing grave economic harm. And if the Washington establishment is trying to insure control of the budget by scaring those who must make the relevant decisions about the budget, they'd better succeed quickly and visibly, before they scare interest rates up as well. The American economy can hardly afford to pay twice in rapid succession for a misguided and irresponsible fiscal policy.

November 1982

The Swallows of Spring

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Tardiness of the Recovery

Observing the outlook as the economy moves into 1983 is about like standing in the cold March wind watching some early swallows flying around. The swallows must signify that something better is coming, but the temperature feels like winter. There are some harbingers now of better economic things to come. Historically, as business activity declines during a recession, changes in the internal structural patterns of the economy begin to signify that a turnabout is ahead. The most widely publicized of these changing patterns is, of course, the upturn in so-called leading indicators. Another would be the changing relationships between statistics that tend to move more tardily.

These all have been giving encouraging signals. They have been giving encouraging signals for so long, in fact, as to raise questions about whether traditional patterns in the economy have any validity. During the last three decades the index of leading indicators has, on the average, reached its low point and turned upward two months earlier than the general economy; and the maximum lead was six months after the 1953-54 recession. Since this index reached its low point in March last year, history suggests that it is high time for business activity generally to get the message and start doing better. The indexes of coincident and lagging indicators would point to a similar conclusion. If the average lead had prevailed here, business conditions generally would have begun to improve after August last year; and even if the more drawn-out pattern that occurred in 1954 had been duplicated this time, the economy would have reached its low point last October. And if the decline in business activity that began after July 1981 had been of only average duration, business activity would have been rising since May 1982.

Reasons for the Delay

Obviously these average historical patterns have not prevailed during the deterioration of business activity that began in mid-1981. Why?

There are two sets of reasons. One is that the early 1980s were destined to be the time when economic policies, largely monetary policies, persisted in the effort to re-stabilize the price level. This was bound to be a difficult task. By the turn of the decade the rate of inflation was well into the double digit range—completely out of context with our historical average of about 2 percent per year. And it came after numerous earlier aborted efforts to re-stablize the economy going back to 1966, and this led businesses, consumers, and unions to assume that once again the effort would be dropped as soon as an economic pinch threatened. Thus the momentum of decisions in the private sector and a disinflationary program which this time would persist got on a collision course.

This collision was made more severe by the erratic path that monetary policy established for the growth of the money stock and by the exceptionally large federal deficits that contributed to unease in financial markets. As the 1980s opened, however, the nation had to choose between countering the inflation, and thereby incurring near-term trauma, or temporizing further, and incurring the growing risk of a much more serious collapse.

TABLE 1. Annual Rate of Increase in the Money Stock

Period	M1	M2
12/79-05/80	0.0%	6.3%
05/80-11/80	15.2	12.9
11/80-02/81	1.8	5.5
02/81-12/81	5.9	10.4
12/81-12/82*	8.0	9.5

*Preliminary estimate.
Source: Basic data, Federal Reserve System.

The timing of this program to counter the inflation also happened to catch the economy with an overloaded inventory condition. On the average businesses will, in a strong economy, keep stocks in inventory equal to about 7 weeks of sales. By mid-1981 these stocks were equal to 7.6 weeks of sales, and this at a time when credit was not readily available and the cost was high. Businesses, in short, found their inventories to be $40-50 billion too large on the eve of the recedence in business activity.

Excessive inventories and tightening credit conditions have always been an explosive combination. The history of particularly sharp recessions (e.g., 1920, 1938, 1958, and now 1982) is dramatically clear about that. Moreover, this was occurring at a time when the financing requirements to cover the federal deficit were large, and this put further pressures on potential borrowers in the private sector. Indeed, the deficit for fiscal year (FY) 1982 was larger, relative to the size of the economy, than the Johnson deficit of FY 1968, which was widely credited with having set us off on the path of inflation in the first place (Table 2). (The 1968 deficit occurred, however, in an economy that was already experiencing overly full employment.)

TABLE 2. Deficit as a Percent of GNP

Fiscal Year	Percent
1968	3.0
1971	2.2
1976	4.0
1982	3.6
1983*	6.0

*Rough preliminary estimate.
Source: 1968-76, *Budget of the U.S. Government, Fiscal Year 1983*, February 1982, p. 9-60; 1982, *Economic Indicators*, November 1982.

And only about half of the FY 1982 deficit was accounted for by the special impact of the recession on the budget (through lower revenues and higher outlays for such programs as welfare and unemployment compensation).

Problems Shadowing the Outlook

Where do we go from here? That is always the much-explored question in the early days of a new year. There is clearly more than the usual uncertainty as businesses try to make their decisions for the period ahead. Two problems still overhang the domestic economic outlook. One is that inventories continue to be too high overall for this stage of the business cycle. Businesses in the first half of last year did make some headway toward reducing these overly heavy stocks, but they rose again after mid-year; and they were about $25 billion higher, by the end of 1982, than what would have been in line with our historical experience at the low point of a recession. Thus the volume of business loans at the larger banks which report these data weekly rose at the rate of 18 percent per year to last October—in sharp contrast to the normal tendency for a decline during a recession. In October these loans began to decline, however, and this was good news not only for credit markets but for business conditions in 1983—suggesting, as the decline does, that the inventory overhang had finally become somewhat less severe (though not absent) as we moved into 1983.

Another major cloud hanging over the U.S. economy is our weak external trade position. By the third quarter of last year exports were falling short of imports at the rate of $42 billion per year, compared with $28 billion in 1981 and $25 billion in 1980. Moreover, the O.E.C.D. projects that our unfavorable trade balance might be as large as $55-60 billion this year. These are large figures, even for the U.S. economy. Part of the problem here is the sluggish pace of economies that constitute our major export markets. Our five largest external markets are, in order of importance, Canada, Japan, Mexico, the United Kingdom, and the Federal Republic of Germany. Most of these economies have been having their own domestic economic problems, and troubled domestic economies do not make for expanding imports from the U.S.

Moreover, there has been a serious overvaluation of the dollar's exchange rate, making U.S. products less competitive. The arithmetic is dramatic. Suppose an item, in 1980, carried a price tag of $1,000 in the U.S. and 203,000 yen in Japan. Since the exchange rate was 203 yen per dollar, the prices would have been equal in the two countries. Our producer price index for finished goods in 1982 was 13.4 percent above that for 1980, so this "average" product last year would have carried a U.S. price tag of $1,134. The yen exchange rate, however, was 255, so the Japanese buyer here would find that this translated into 289,000 yen, up 42 percent from the price confronting him two years earlier.

Suppose now we look at it the other way around. Japan's domestic price level rose only 3.2 percent during these two years, so this "average" product, which cost 203,000 yen in 1980, would have carried a 1982 price tag of 209,500 yen. Last year, however, the American buyer could get 255 yen for a dollar (on the average), so the dollar cost of this product was $821.60, almost 18 percent *lower* than in 1980. Much the same (though less dramatic) arithmetic would show up in comparisons with our other important trading partners. Not surprisingly, therefore, our external trade has not been doing well.

Factors Favoring an Upturn

There is, however, hope for 1983. Recessions do not last forever. Moreover, there are some tangible omens now of better things to come. A sequence of three things had to occur before a recovery could get underway, and this sequence has now occurred. The rate of inflation had to come down far enough for people to become believers. When this occurred, interest rates could be expected to drop. With lower interest rates the stock market would rise. The latter was important not because of any special compassion for the rich, but to improve the market value of companies relative to their carcass value. (Since pension funds are massive owners of common stocks, practically everybody had an important stake in a better stock market.)

The early responses to improved credit markets have already occurred. Housing starts have been rising irregularly. The trend for new car sales has been upward since 1982's second quarter. As housing improves, the appliance market should strengthen. Finally, though they always come along tardily, capital outlays will start to show some life.

The encouraging trend of costs and prices suggests that once this expansion gets going it could be in for a long run. If rates of increase in compensation can continue to moderate, labor costs per unit of output (assuming strong gains in productivity which the expansion almost certainly will deliver) should not rise more than 2-3 percent or so in 1983, and this would be the good news of the year for those hoping that an expanding economy will take them off unemployment roles (Table 3).

TABLE 3. Rise in Prices and Hourly Labor Rates During the Year

Year	Prices[1]	Labor Rates[2]
1975	7.0%	7.8%
1976	4.8	8.3
1977	6.8	7.5
1978	9.0	9.0
1979	13.3	9.7
1980	12.4	10.4
1981	8.9	8.9
1982	5.5[3]	5.5[3]

[1]Rise in consumer price index.
[2]Rise in average hourly compensation, all employees, nonfarm business sector.
[3]Preliminary estimate.
Source: Basic data, U.S. Department of Labor. Increases are from December to December.

As 1983 opened, the basis was being established for an ultimate improvement in our external trade position with the decline in the exchange rate of the dollar toward a more normal range. Basic trade patterns change slowly, however; and little of this improvement will show up until late 1983 and 1984. If the economy this year achieves a gain in real terms of 2-3 percent, a quite conventional expectation, manufacturing and trade sales in real terms could gain about 5 percent. This would be a modest gain by standards

of history, but it would go a long way toward a better economy and better sentiment about our prospects.

This would, if realized, have a particularly favorable effect on the automobile segment of the economy. Historically, once the economy begins to improve after a recession, the auto component of the economy experiences a leveraged rise (Table 4). Thus if the historical average relationship were to prevail this time, a 2-3 percent gain for the economy would push new car sales for 1983 into the 9 million zone, with a higher rate by year-end. If so the months of, in Thomas Gray's words, "Grim-visag'd comfortless Despair" could finally start to move behind us.

January 1983

TABLE 4. Increase in Total GNP and Auto GNP During Year Following Recession Low

Year of Recession Low	Total GNP	Auto GNP
1954	7.4%	20.0%
1958	6.9	10.2
1961	6.4	2.8
1970	4.7	40.0
1975	6.7	20.1
Average	*6.4*	*18.6*

Source: Basic data, U.S. Department of Commerce.

Buying Attitudes Improve

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Modest Overall Improvement

The Index of Consumer Sentiment was 72.5 in the fourth quarter 1982 surveys, the highest level recorded during the past year. The Index remained in the narrow range of 65.7 to 66.7 in each of the prior four quarterly surveys. The nearly six Index-point improvement reflects net gains from offsetting trends, not widespread cumulative improvements, in the attitudes and expectations of consumers. Reductions in prices and interest rates led to greatly improved buying attitudes in late 1982. At the same time, income declines and the expected persistence of double-digit unemployment levels left consumers' evaluations of their current financial situation and of business conditions at very low levels.

Lower Prices and Interest Rates Brighten Spending Prospects

Attitudes toward buying conditions for large household durables, vehicles, and houses each improved in the fourth quarter 1982 surveys from the one quarter and one year earlier readings. Attitudes toward buying conditions for vehicles were more favorable in the fourth quarter 1982 surveys than at any time since the first quarter of 1979. Among all families, 47 percent rated buying conditions favorably for automobiles in the fourth quarter, up from 36 percent in the fourth quarter 1981. Unfavorable attitudes toward market conditions for vehicles, held by 54 percent at year-end 1981, fell to 44 percent in the fourth quarter 1982 surveys. Attitudes toward buying conditions for houses improved by the greatest extent during the past year, with the proportion holding favorable house-buying attitudes rising to 38 percent in the fourth quarter of 1982, up from 21 percent in the third quarter, and more than twice the 18 percent recorded one year earlier. Unfavorable views of market conditions for houses were held by 57 percent of all families in fourth quarter 1982, down from 71 percent in the prior quarter and 76 percent in fourth quarter 1981. A favorable balance of opinion was also recorded toward market conditions for large household durables. Among all families, 48 percent rated buying conditions for durables favorably, up from 46 percent one year ago. Durable buying conditions were rated unfavorably by 40 percent in the fourth quarter of 1982, virtually unchanged from the 41 percent in the fourth quarter of 1981.

TABLE 1: References to Prices and Interest Rates in Evaluations of Market Conditions

	Prices						Interest Rates					
	1981			1982			1981			1982		
Markets	Low Prices	High Prices	Low Minus High	Low Prices	High Prices	Low Minus High	Easy Credit	Tight Credit	Easy Minus Tight	Easy Credit	Tight Credit	Easy Minus Tight
Durables	22%	23%	− 1	30%	17%	+13	2%	20%	−18	6%	15%	− 9
Vehicles	21	35	−14	31	25	+ 6	5	27	−22	19	17	+ 2
Houses	9	26	−17	18	18	0	5	81	−76	29	50	−21

Two major factors are responsible for these improved market attitudes. Declines in prices during the past year led consumers to hold more favorable views toward market conditions; and, starting at mid-year, declines in interest rates led consumers to view credit purchases more favorably. Table 1 shows the proportion of families that mentioned prices or interest rates in explaining their views on the markets. By year-end 1982, families mentioned lower prices more often than higher prices in their evaluations of market conditions, in contrast to the fourth quarter of 1981 when negative views on prices predominated. Consumer perceptions of market prices have not been this favorable since the early 1960s.

Consumer perceptions of interest rates have also changed dramatically during the last year. At year-end 1981, 81 percent of all families mentioned high mortgage rates when evaluating buying conditions for houses; this proportion fell to 50 percent by fourth quarter 1982. At the same time, references to lower mortgage rates and more favorable credit terms rose from 5 to 29 percent during the past year. Similarly, mentions of high interest rates with regard to the automobile market declined sharply during the past year (from 27 to 17 percent), while mentions of the availability of lower interest rates on auto loans rose substantially (from 5 to 19 percent). Consequently, at year-end 1982, more families mentioned the availability of lower interest rates on auto loans than mentioned high interest rates.

Backlog of Postponed Purchases

Declines in interest rates have been a prevalent expectation throughout most of 1982. In the fourth quarter 1982 surveys, twice as many consumers expected interest rate declines as expected increases during the year ahead (46 versus 22 percent). The fourth quarter 1982 surveys recorded continued postponement of purchases due to high interest rates. Among all families, 33 percent reported that they had postponed a purchase, down from 34 percent in third quarter 1982 and fourth quarter 1981 (see Table 2). Vehicles continued to be the most frequently postponed purchase in the fourth quarter surveys (14 percent), followed by household durables (10 percent) and houses (9 percent). Since the question asks about postponement any time during the prior six months, the recent interest rate declines are not reflected in the median reported rate that would have been charged on postponed purchases, which remains largely unchanged at 17.4%. Declines in market rates appear not to have led to significant declines in the rate consumers would have been willing to pay. In the fourth quarter 1982 surveys, the median interest rate consumers would have been willing to pay was 11.7%, down only slightly from 11.9% in the third quarter.

Business Improvement Expected Despite Unemployment

At year-end 1982, three-fourths of all consumers continued to view the economy in recession, a level largely unchanged during the past year. When asked about recent economic developments, on average half of all respondents during the last six months of 1982 mentioned unemployment—48 percent in the fourth quarter. Compared with inflation, unemployment was viewed as the more serious economic problem facing the nation by the widest margin recorded during the past decade (72 versus 18 percent). At year-end 1982, three-fourths of all families expected unemployment to remain at the double-digit level in the year ahead. Compared with a year earlier, a rising unemployment rate was expected less frequently (38 percent in 1982:4, down from 54 percent in 1981:4), while expectations that unemployment would remain unchanged at its current level rose in frequency (33 to 39 percent). Few consumers expected declines in the unemployment rate to occur in 1983 (21 percent), although a decrease was more frequently expected than it had been one year earlier (11 percent).

TABLE 2: Interest Rate Effect on Consumer Purchases During the Past Year

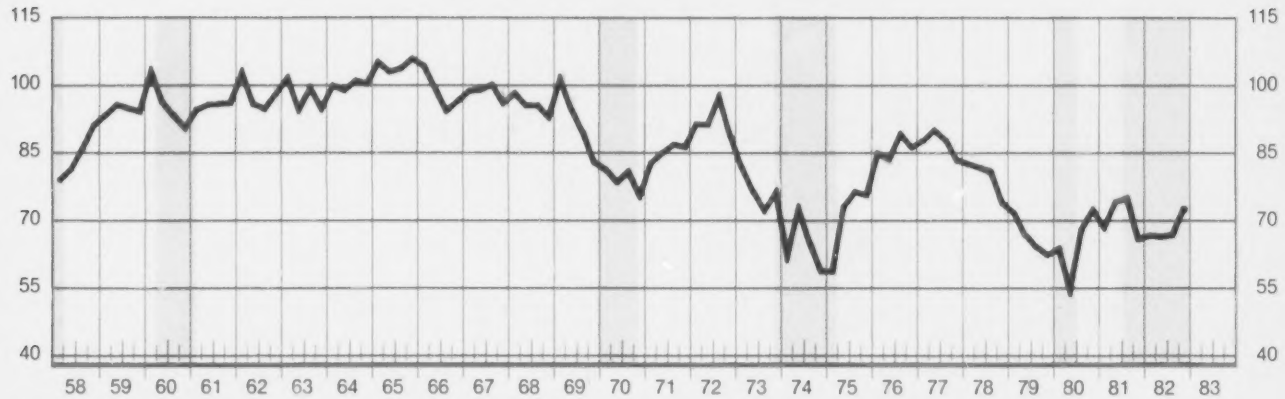
	1982:1	1982:2	1982:3	1982:4
Proportion postponing purchase	33%	32%	34%	33%
Interest rate that would have been charged on postponed purchase*	17.7%	17.5%	17.6%	17.4%
Highest interest rate willing to pay to make purchases*	12.0	11.9	11.9	11.7
Difference between interest rate charged and that willing to pay*	5.1	5.1	5.3	4.7

*Median values for families who postponed a purchase.

The questions asked were "Have interest rates caused you to postpone making any purchases during the last six months? What was postponed? What interest rate would have been charged on any money borrowed for (item)? What is the highest interest rate at which you would have purchased (item)?"

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

Despite these persistent concerns with unemployment, business conditions were expected to improve during the year ahead due to declines in inflation and interest rates. In the fourth quarter 1982 surveys, 39 percent of all families expected business conditions to improve, compared with 20 percent who expected further declines. Business expectations were thus more favorable in late 1982 than one year earlier, when nearly equal proportions expected improvement as deterioration (29 versus 27 percent). When respondents were asked to explain their views on upcoming business conditions, the persistently high level of unemployment was the primary unfavorable factor mentioned.

Although the expectation that the economy will improve during the year ahead has spread, because of concern with unemployment few expect the return of good times financially. In the fourth quarter 1982 surveys, the majority (57 percent) expected bad times financially in the economy as a whole during the next 12 months, while 33 percent expected good times financially. The fourth quarter 1982 evaluations represent an improvement over year-end 1981, when bad financial times were expected by a margin of almost three-to-one over good times (64 versus 23 percent).

Price Declines Brighten Financial Prospects Despite Income Declines

In each quarter of 1982, families more often reported that their financial situation had worsened rather than improved during the prior year. In the fourth quarter 1982 surveys, 41 percent reported that their financial situation had worsened, compared with 31 percent that reported improved personal finances, a level largely unchanged from one year earlier. Declines in family income have been the primary factor responsible for these persistently unfavorable views. On average, one-in-five families mentioned income declines throughout 1982 (22 percent in the fourth quarter), the highest level recorded during the past two decades.

Despite their unfavorable current situation, families have become more optimistic about the prospects for improvement in their personal financial situation in the year ahead. In the fourth quarter 1982 surveys, twice as many families expected improvement rather than declines in their financial situation (35 versus 16 percent). These favorable prospects are not based on expectations of renewed growth in nominal incomes, but rather on increases in purchasing power due to lower rates of inflation. Among all families, the expected rate of inflation was 5.6% in the fourth quarter of 1982, down from 5.9% in the third quarter and 6.9% in the fourth quarter of 1981. The decline in the expected inflation rate has led to the most favorable real income expectations recorded since this question was introduced nearly a decade ago. In the fourth quarter 1982 surveys, nearly two-thirds of all families expected their income increases to match or exceed the expected rate of inflation.

Summary Outlook

The most distinctive aspect of recent trends in consumer sentiment has been the sharp divergences produced by changes in unemployment, inflation, and interest rates. The current record level of unemployment has been reflected in the very bleak evaluations of the current state of the economy. And although business conditions are expected to improve in the year ahead, the improvement is anticipated to be small due to the expected persistence of high unemployment. At the same time, declines in inflation have led to more favorable financial expectations and more favorable views toward product prices. And during late 1982 a heightened awareness of declines in interest rates was recorded, coupled with the expectation that these declines would continue in the year ahead. Interest rate declines are expected to help improve business conditions generally, as well as buying conditions for houses and cars. While declines in consumer loan rates, coupled with favorable views of market prices, will release pent-up demand, the increase in consumer sales will be constrained by cautious spending plans dictated by concerns with unemployment. A modest but cumulative recovery in consumer sales during 1983 will depend both on sustained declines in consumer loan rates and on renewed growth in household incomes.

January 1983

Some Economic Policy Opinions of Business Economists

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Since May of 1982 the Survey Research Center has been interviewing a self-selected "sample" of members of the National Association of Business Economists. These quarterly interviews have solicited forecasts of various economic series and opinions about current economic policy matters. F. T. Juster discussed the implications of these respondents' price expectations for long-term interest rate movements in an earlier article,* and the NABE has released their economic forecasts shortly after the data have been collected each quarter. We focus here on the business economists' opinions about various aspects of economic policy.

Monetary and Fiscal Policy

The only policy question about which we have trend data is the NABE respondents' evaluations of fiscal and monetary policy. In each of the three interviews conducted so far, respondents were asked "Do you think *monetary policy*, as you see it being implemented now, is too easy, too restrictive, or about right?" and "Do you think *fiscal policy*, as you expect it to be implemented during fiscal years 1983 and 1984, will be too easy, too restrictive, or about right?" The responses are summarized in Table 1.

Concerning monetary policy, it is clear that majority opinion has been supportive of the policy existing during each of the survey periods; but such dissatisfaction as did occur was heavily on the "too restrictive" side during May and August. By November, however, following the loosening of monetary policy during the fall, almost 80 percent viewed monetary policy as "about right," with the balance being fairly equally divided between the "too easy" and "too restrictive" alternatives.

Concerning fiscal policy, there was a clear consensus in May that it was too loose; and this viewpoint became even more commonly held by the August and November surveys, as expectations of unacceptably large federal deficits became more widespread. Even in May, after having been asked to estimate the fiscal year 1983 deficit, 82 percent of the business economists said they viewed that figure as "undesirably large." In August almost all respondents projected a larger FY '83 deficit than the then-recent Congressional budget resolution, with about three-quarters explaining that they anticipated both higher federal spending and lower tax receipts than were contained in the official estimates.

*F. T. Juster, "The Interest Rate Puzzle: Some Clues," ECONOMIC OUTLOOK USA, 9:3 (Summer 1982), pp. 59-60.

TABLE 1: Opinions about Monetary and Fiscal Policy, May-November 1982

Policy and Survey Month	Too Easy	About Right	Too Restrictive
Monetary Policy:			
May	5%	69%	26%
August	4	74	22
November	8	79	13
Fiscal Policy:			
May	66	29	5
August	75	19	6
November	75	18	7

Agreement and Disagreement with Reaganomics

In the May survey the 82 percent of all respondents who viewed their projected deficit as too large were asked whether they agreed or disagreed with a number of proposed options to reduce the budget deficit. Their evaluations of the various options revealed that even among this group of presumably conservative and business-oriented economists there was substantial disagreement with some of the generally understood tenets of Reaganomics. For example, there was substantial willingness to accept higher personal and business taxes:

- 64 percent agreed with a proposal to "increase excise taxes or impose some other form of consumption tax,"
- 62 percent agreed with a proposal to "eliminate or reduce the sales/leaseback tax credit provision of the 1981 tax legislation,"
- 61 percent agreed with a proposal to "impose an oil-import fee,"
- 44 percent agreed with a proposal to "eliminate, reduce, or defer the July 1983 installment of the personal income tax cut," and
- 42 percent agreed with a proposal to "impose a minimum tax on corporations."

Perhaps the most striking area of disagreement was defense spending: fully 86 percent of the business economists agreed that "slow[ing] the defense buildup" was a desirable way of reducing the deficit, and this was selected by the second largest number (28 percent) as the "*most desirable* way of decreasing prospective federal deficits."

A final substantial point of disagreement, uncovered in the November survey, was with the proposed balanced budget constitutional amendment: 66 percent disagreed with this course of action, and 47 percent "strongly" disagreed.

Of course the surveys also revealed substantial areas of *agreement* with Reagan administration economic policy. In the May survey's list of options to reduce the budget deficit, 85 percent of the business economists disagreed with "eliminat[ing] or reduc[ing] the investment tax credit," 79 percent agreed with reducing nondefense spending other than entitlement programs, and 71 percent agreed with "speed[ing] up natural gas decontrol" (but in association with a windfall profits tax, which Reagan has not proposed). The administration has made some noises in support of a flat-rate income tax, and in August about 75 percent of respondents agreed with that general idea.

Social Security

In the May survey's list of deficit-reducing options, the largest proportion—90 percent—of respondents agreed with a proposal to "curtail the rise in social security benefits and/or other entitlement benefits"; and almost half selected this option as the most desirable way of decreasing prospective deficits. Opinions about the social security system were solicited in more detail in the November survey, and 95 percent of the business economists said they favored making some changes in the current system. This 95 percent was then asked to agree or disagree with three specific proposals for modifying social security; the results are presented in Table 2. Only about a third supported increasing social security taxes, but strong majorities favored reducing the rate of increase of benefits (82 percent "strongly" agreed) and gradually raising the eligible retirement age.

TABLE 2: Opinions about the Social Security System

Proposed Change	Strongly Agree	Somewhat Agree	Somewhat Disagree	Strongly Disagree
Increase Social Security Taxes	6%	28%	24%	42%
Change Indexation of Benefits to Reduce Rate of Increase	82	13	3	1
Gradually Raise Eligible Retirement Age	51	35	9	6

Federal Reserve Policy

Opinions about oversight of the Federal Reserve system and its methods of controlling the money supply were asked for in November; the results are displayed in Table 3. There was almost no support for making the Fed subordinate to the Treasury Department and little support for requiring the Fed to target either nominal or real interest rates rather than reserves or monetary aggregates as the primary means of controlling the money supply.

TABLE 3: Opinions about the Federal Reserve System

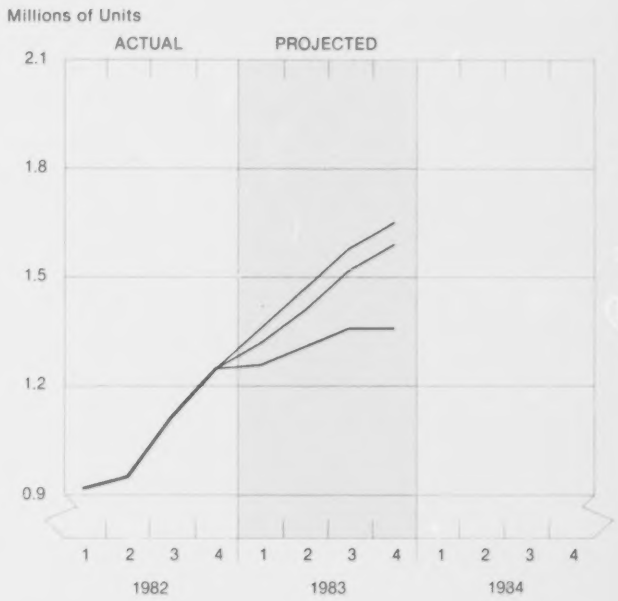
Proposed Change	Favor Change	Oppose Change
Make Federal Reserve Subordinate to U.S. Treasury	5%	95%
Require Federal Reserve to Target Nominal Interest Rates*	14	86
Require Federal Reserve to Target Real Interest Rates*	16	84

*This rather than targeting reserves or monetary aggregates as principal means of controlling money supply.

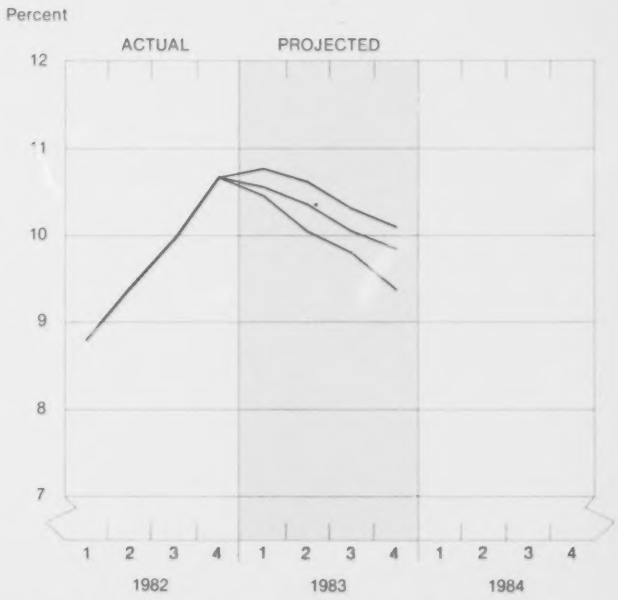
Finally, respondents to the August survey were asked about selective credit controls as a supplement to the Fed's present monetary policy tools. Only 15 percent agreed "strongly" or "somewhat" with such a proposal.

We shall report additional findings from the continuing NABE surveys in future issues of OUTLOOK.

NEW PRIVATE HOUSING UNITS STARTED



UNEMPLOYMENT RATE



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

The Economy and the Forecasts after a Bad Year

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New Depression Economics?

1982 was indeed a bad year for both the economy and those who tried to predict it. The longest slump of the post-World War II era has spread through the industrial and trading world, with the highest unemployment and lowest capacity utilization levels recorded most recently at year-end. And the length, size, and scope of the decline have all been generally and greatly underestimated.

Inevitably, fears of another debacle on the scale of the 1930s have resurfaced, challenging the previously dominant view that another depresson is most improbable. They feed upon some rough but disturbing analogies. There are the new-old international problems: large swings in exchange rates, with the dollar once undervalued now overvalued; rising tension over competition from foreign imports; and overextension of credit to economically weak or unstable countries. These developments are linked to the escalation and decline in oil prices and the OPEC cartel fortunes, political and financial shocks around the world, and uncoordinated national economic policies. They raise the threats of growing imbalances of trade, pressures to use protectionists tactics, and major insolvencies. More insidious and perhaps more troublesome yet is the intellectual confusion about what could and should be done to improve the situation. The underlying cause is the present crisis in modern macroeconomics, which I believe reflects in large part the long neglect of business cycle problems in both Keynesian and monetarist theories. Despite the lack of support from either line of thought in mainstream economics, certain untested "supply side" ideas gained the upper hand for a time in the political process, resulting in improvised but far-reaching fiscal innovations. The popularity of these ideas faded, however, when the promised prompt and painless solutions failed to materialize.

None of the earlier recessions since 1948 lengthened and deepened beyond even the more pessimistic expectations the way this one did. Further, none persisted for so long after many of the leading cyclical indicators had turned up, though it is necessary to add that this time such upturns were also much more scattered and for the most part weaker than on the other recent occasions. However, precedents of contractions bottoming out slowly are readily found in the history of business cycles of the era before World War II.

Yet, for all these worrisome observations, it is clear that the differences between the early 1980s and the early 1930s (or other depressions of the past) far outweigh any similarities. During the three years 1980-82, real GNP fell in five quarters and rose in seven. The declines ranged from 1.5 to 9.6 and averaged 4.8 percent at annual rate; the increases ranged from 0.7 to 7.9 and averaged 2.9 percent. The longest decline lasted two quarters, the longest increase three quarters. The net result of these highly uneven movements was a loss of 1.2 percent between 1979:4 and 1982:4. This is clearly not the persistent and pervasive fall in total output expected of a single severe business-cycle contraction. What happened instead is best described as a sequence of two recessions, the first one steep but very short in the first half of 1980, the second meandering but thrice as long, since mid-1981. This pattern is much more articulate in employment than in output and is sharp for goods-producing industries only, particularly the durables as usual (in the aggregate, services show no contraction at all in this period, merely slower growth in real terms). The rebound between mid-1980 and mid-1981 produced some net gains in total output and employment, but it was by the standards of historical expansions extremely short and weak.

Inflation, having gained so much momentum during the 1970s, decreased strongly in the stagnant years 1980-82, which is as much as anyone could have expected. There is a long way from such a disinflation to the deflations associated with the severe depressions of the interwar and earlier periods, and we had better be spared from traversing that way. On the other hand, it would certainly be desirable for a slow disinflation to continue. Unfortunately, the behavior of interest rates suggests that a sufficiently large and lasting reduction in the expectations of future inflation has not yet been achieved. For some three months now the decline in bond yields has stalled, despite some moderate reductions in short-term interest rates. The long-term real interest rates remain very high and an obstacle to a strong recovery. The common explanation centers on the evident aversion of the financial markets to the projected deficits in the federal budget, which are indeed very large. Apparently many fear that these deficits will be to a large extent monetized, with strong inflationary consequences. If not monetized, their effect should be to raise future (not present) real interest rates, which would work against a strong expansion and inflation in the coming years.

Where the Forecasts for 1982 Went Wrong

As the attached table shows, in December 1981 most forecasters expected that the economy would begin a slow recovery in the spring of 1982. They placed the upturn at least nine months too early. In retrospect it is apparent that the risk that the sluggish demand conditions would persist was not sufficiently appreciated, although a minority did "worry that the recession may be more severe and longer than the consensus forecast implies" (as reflected in their estimates of the probabilities that real GNP will decline; see OUTLOOK, Winter 1982, p.11). The sources of the error were several. Many assumed that the dollar would weaken and overestimated net exports. Some expected the Fed to speed up monetary growth. Certainly the strong negative reaction of the financial markets to the prospect of large budget deficits was not effectively taken into account, despite all the attention it received. (To be sure, the forecasts made later during 1982 reassessed these matters with the benefit of some hindsight and reduced some of the errors considerably.)

THE ECONOMY IN 1982: PREDICTED VS. ACTUAL CHANGES

	Quarterly Changes				Annual Changes	
	1981:4-1982:1 (1)	1982:1-1982:2 (2)	1982:2-1982:3 (3)	1982:3-1982:4 (4)	1981-1982 (5)	1981:4-1982:4 (6)
GNP in Current Dollars[1]						
Predicted	1.7	2.6	3.2	3.1	8.7	11.1
Actual	-0.3	1.7	1.4	0.4	4.1	3.3
GNP in Constant Dollars[1]						
Predicted	-0.2	0.9	1.2	1.2	0.5	3.2
Actual	-1.3	0.5	0.2	-0.6	-1.8	-1.2
Implicit Price Deflator[1]						
Predicted	1.9	1.8	1.6	1.9	7.9	7.4
Actual	1.0	1.1	1.2	1.1	6.0	4.5
Index of Industrial Production[1]						
Predicted	-1.3	1.7	2.3	1.9	0.7	4.7
Actual	-3.1	-1.7	-0.9	-2.2	-8.2	-7.6
Unemployment Rate[2]						
Predicted	0.2	-0.1	-0.1	-0.3	0.7	-0.3
Actual	0.4	0.5	0.3	0.7	2.1	2.3
Corporate Profits After Taxes[1]						
Predicted	-0.6	6.7	6.7	5.7	0.0	19.2
Actual	-20.6	1.1	2.7	0.8*	-22.0*	-17.2*
New Private Housing Starts[1]						
Predicted	11.0	20.0	8.3	15.4	18.2	66.7
Actual	6.4	3.5	17.4	12.0	-2.4	44.8
Consumption Expenditures in Constant Dollars[1]						
Predicted	0.4	0.5	1.0	1.2	1.8	3.1
Actual	0.6	0.6	0.1	1.2	1.0	2.6
Nonresidential Fixed Investment in Constant Dollars[1]						
Predicted	-0.9	0.0	1.3	2.5	-0.6	2.8
Actual	-1.2	-3.1	-2.0	-2.3	-3.8	-8.4
Change in Business Inventories in Constant Dollars[3]						
Predicted	-4.9	4.5	0.4	1.7	-3.0	1.7
Actual	-20.2	11.0	7.8	-21.1	-17.5	-22.5
Treasury Bill Rate (3 months)[4]						
Predicted	-1.0	0.2	1.0	0.6	-2.5	0.8
Actual	0.9	-0.5	-2.6	-2.1	-3.4	-4.1

[1]Percent changes.

[2]Differences, percent of labor force.

[3]Differences, billions of 1972 dollars.

[4]Differences, percentage points.

Sources: *Predicted* changes are based on median forecasts from the December 1981 ASA-NBER survey. *Actual* changes are based on figures reported in the December 1982 issue of *Business Conditions Digest* for the four quarters 1981:4-1982:3 and on the more recent (January 1983) releases for 1982:4. In the cases marked * actual estimates for 1982:4 are not yet available and the median forecasts from the December 1982 ASA-NBER survey are used.

The failure to anticipate the duration of the recession, which was widespread, invalidated the predictions for many variables over a succession of the quarters covered, as would be expected. The predictions of unemployment turned out to be much too low, those of inflation much too high. The largest relative errors refer to the cyclically sensitive series, namely business fixed and inventory investment in constant dollars, industrial production, and corporate profits. Here most of the substantial declines were either missed altogethet or underestimated, and some small rises were overestimated. The predictions of changes in the Treasury bill rate have wrong signs (corporate bond yields, not shown, were forecast with much smaller errors). On the other hand, real consumption expenditures and housing starts were correctly predicted as rising, though their increases were overstated (in the case of consumption not so strongly).

The Uncertanties and Prospects for a Brighter Future

Chances are high that the U.S. economy is right now passing through the trough stage of the current business cycle on its way up toward a new recovery. The latest news indicates continuing and somewhat accelerated improvements in most of the sensitive cyclical indicators. Contracts and orders for plant and equipment in 1972 dollars rose sharply (21.7 percent) in December, suggesting that an upturn in this important predictor of business fixed investment may have occurred late in the summer of 1982 and that a somewhat stronger upward trend in it may be developing (but there is a large erratic component in the month-to-month changes of this volatile series). New orders for consumer goods and materials also gained in real terms, though not strongly. (Defense orders and spending, a separate category, will certainly continue to increase at a fast albeit irregular pace). New housing permits moved up, regaining about half of the ground they lost during the long decline of residential fixed investment between mid-1978 and the end of 1981 (much the same applies to the more volatile housing starts). A very large decline in real inventories on hand and on order occurred in the last months of 1982. Although the inventory-sales ratio is still high, it has declined, improving the prospects for an early completion of the inventory liquidation phase. If final sales now improve, inventory investment should do so too and soon.

The weather has been predominantly good this winter, supporting further improvement in construction activity and automobile and other retail sales. New unemployment insurance claims have declined about 17 percent in the past 6 weeks compared with their level in the fall of 1982, and on the day this is written (February 4) the first decline in the unemployment rate has been announced (from 10.8 to 10.4 percent on the old civilian labor force basis).

The monetary policy is now strongly stimulative. Inflation in terms of consumer prices slowed to 3.9 percent in the December 1981–December 1982 period and should stay reasonably low in the near future. Real money balances, however measured, are on the rise. More generally, the lower interest rates and higher security values have raised the financial assets of the private sector including importantly the pension funds. All this, plus the effects of the tax cuts (delayed and new), can be expected to influence positively consumer confidence and spending. Fears of job and income losses work strongly in the opposite direction, but better news on the unemployment front should in time dilute this effect.

On the negative side, the economic prospects in Europe and the less developed countries are poor, and so is the outlook for the U.S. export market. A substantial reduction in oil prices would help us as well as most of our trade partners significantly (contrary to some dubious arguments recently advanced), but whether such a lucky break will come our way is still quite uncertain. It is hard to see any other favorable near-term developments abroad. The critical factor for the world economy today is the timing and staying power of the recovery in the United States.

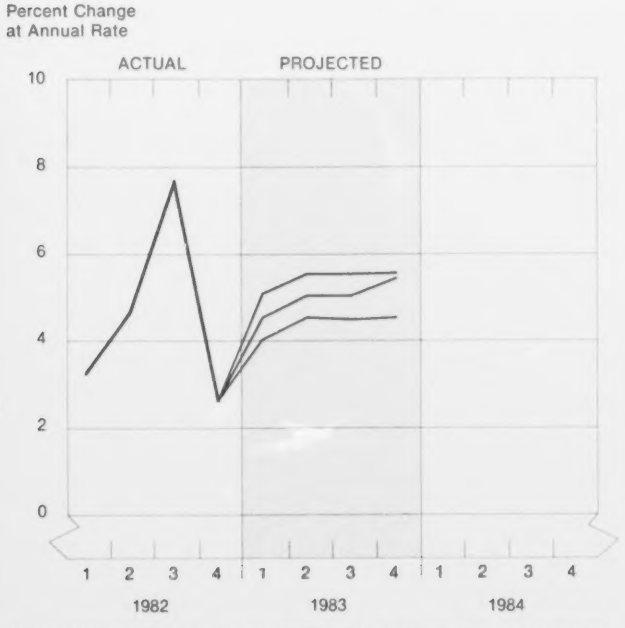
The minimum requirement for a new expansion to get going and stay going is that interest rates do not rise too soon by too much. The shift to an expansionary monetary policy was overdue, and continuing this policy for some time is necessary. At some later time, once an expansion is assured, a more restrictive stance will become appropriate. Counting on lengthy lags in the effect of changes in money and credit is admittedly risky, but no acceptable alternative is presently available. In any event, it is in the fiscal not the monetary area that the current threats to the recovery reside. The prevailing forecast of a relatively slow recovery this year assumes that the market fears of huge budget deficits will be gradually reduced, in part by political compromises and legislative action, in part by the improvement in the economy. The summary results from the December 1982 ASA-NBER survey, presented in tabular and graphical form on these pages, continue to provide a good representation of this scenario.

The recovery may well turn out to be much stronger than this forecast implies, say, 5 to 6 percent rather than 3 to 4 percent in terms of the real GNP rise between 1982:4 and 1983:4. This would require not only that the upturn occurs promptly but also that inflation decelerates some more or at least does not worsen and that interest rates decline further in the near future (unlike the "consensus" forecasts shown in the accompanying charts for CPI and the Treasury bill rate). These conditions are entirely consistent with patterns of past cyclical behavior. Stable or declining inflation and interest rates have often been observed in early stages of business expansions; indeed, interest rates, both short- and long-term, typically lag at troughs, and most of these recent lags have been long (the short recovery in 1980-81 provides the exceptions).

Last but not least, it is helpful to an economy struggling to recover if several other indicators simultaneously undergo slowdowns or declines along with the levels of prices and interest rates. This includes prominently the labor costs per unit of output but also aggregate debt-to-income and inventory-to-sales ratios—all typically lagging series which are related to important categories of business costs. Promising developments of this sort have been underway for some time in this recession.

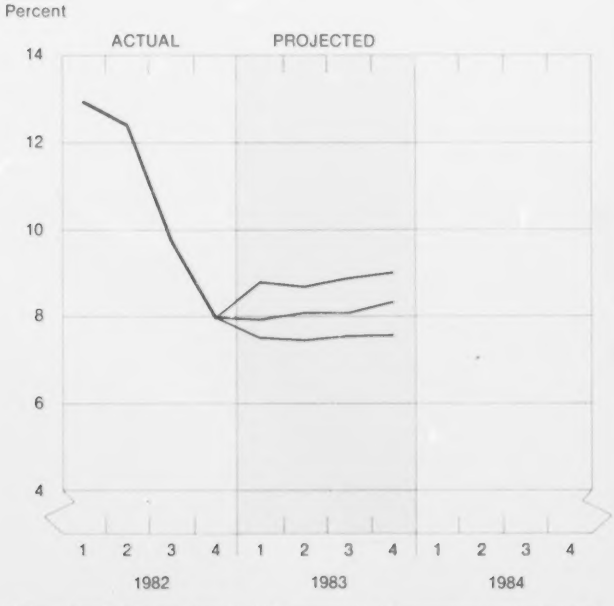
February 1983

CONSUMER PRICE INDEX



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

90-DAY TREASURY BILL RATE



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Actual and Projected Economic Indicators

seasonally adjusted

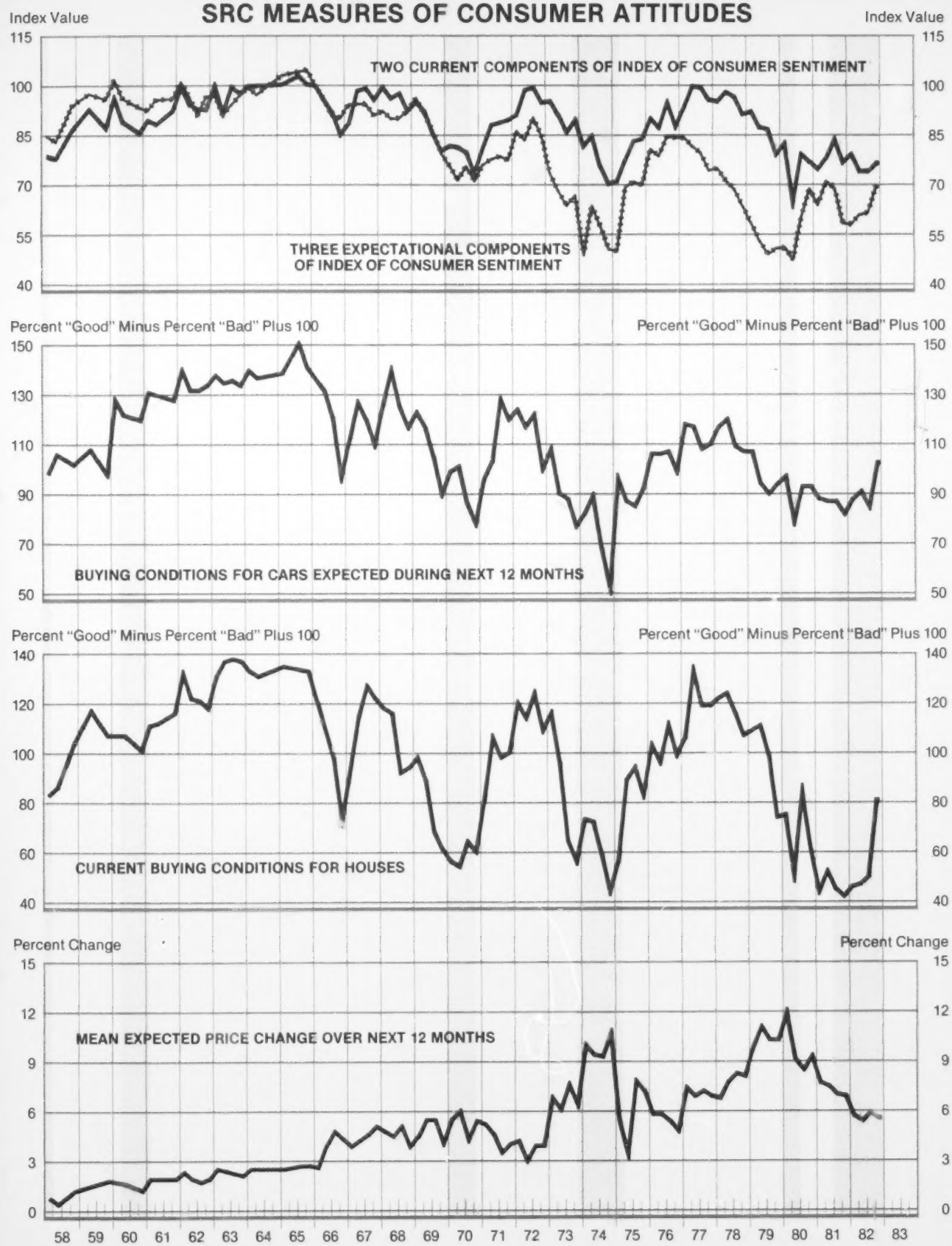
SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Actual		Proj.
	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1982:4	1983:1	1983:2	1983:3	1983:4	1981	1982	1983
GROSS NATIONAL PRODUCT	2,902	2,981	3,003	2,996	3,045	3,088	3,101	3,134	3,194	3,263	3,343	3,430	2,938	3,058	3,307
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	193.2	197.4	201.6	203.7	206.0	208.5	210.7	211.1	213.9	216.6	219.7	222.9	195.5	207.2	218.2
CORPORATE PROFITS AFTER TAXES	146.2	150.8	144.9	115.0	116.3	119.4	NA	120.0	123.0	127.0	133.0	142.1	150.9	NA	130.3
UNEMPLOYMENT RATE (percent)	7.367	7.400	8.300	8.800	9.400	9.967	10.67	10.40	10.30	10.10	9.800	9.600	7.617	9.708	9.900
INDUSTRIAL PRODUCTION (index, 1967 = 100)	152.5	153.0	146.3	141.8	139.4	138.2	135.1	137.0	139.0	141.0	144.0	146.0	150.9	138.6	143.0
NEW PRIVATE HOUSING UNITS STARTED (millions)	1.173	0.962	0.865	0.920	0.952	1.118	1.251	1.150	1.210	1.300	1.400	1.460	1.100	1.060	1.340
CONSUMER PRICE INDEX (% change from prior quarter or year)	7.8	11.8	7.8	3.2	4.6	7.6	2.6	3.9	5.0	5.5	5.5	5.9	10.3	6.1	5.2
90-DAY TREASURY BILL RATE (%)	14.83	15.09	12.02	12.90	12.36	9.71	7.94	7.89	7.85	8.00	8.00	8.25	14.08	10.72	8.10
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	15.22	16.33	16.01	16.14	15.65	14.72	NA	12.25	12.00	11.70	11.50	11.50	15.48	NA	11.78
GNP IN 1972 DOLLARS	1,502	1,510	1,490	1,471	1,478	1,481	1,472	1,485	1,494	1,506	1,522	1,537	1,503	1,475	1,514
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	944.6	951.4	943.4	949.1	955.0	956.3	968.0	964.0	972.0	979.0	987.0	997.0	947.6	957.1	982.0
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	170.1	173.9	174.2	172.0	166.7	163.4	159.6	158.0	156.0	156.0	158.0	161.0	172.0	165.4	158.0
RESIDENTIAL FIXED INVESTMENT (1972 $)	47.3	42.9	39.9	38.9	40.1	39.5	41.7	42.0	44.0	46.1	49.0	50.5	44.9	40.1	48.0
CHANGE IN BUSINESS INVENTORIES (1972 $)	12.1	16.5	4.8	-15.4	-4.4	3.4	-17.7	-3.0	0.0	2.0	3.1	5.0	9.0	-8.5	2.7
NET EXPORTS (1972 $)	44.2	39.2	36.5	36.9	35.7	27.5	21.1	28.3	28.0	28.0	27.5	27.5	42.0	30.3	28.0
FEDERAL GOVERNMENT PURCHASES (1972 $)	107.0	110.7	116.0	114.4	110.3	116.2	123.7	118.0	118.0	119.0	120.0	121.0	110.4	116.2	120.0
STATE & LOCAL GOVERNMENT PURCHASES (1972 $)	176.9	175.7	175.3	174.9	175.0	174.9	175.4	175.0	174.0	174.0	175.0	175.0	176.7	175.1	174.1

SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1980:1	1980:2	1980:3	1980:4	1981:1	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1980	1981	1982
GROSS NATIONAL PRODUCT	2,576	2,573	2,644	2,739	2,865	2,902	2,981	3,003	2,996	3,045	3,088	3,101	2,633	2,938	3,058
PERSONAL CONSUMPTION EXPENDITURES	1,619	1,622	1,682	1,746	1,800	1,819	1,869	1,885	1,919	1,948	1,986	2,035	1,667	1,843	1,972
GROSS PRIVATE DOMESTIC INVESTMENT	424.0	391.0	384.1	410.3	455.7	475.5	486.0	468.9	414.8	431.5	443.3	397.9	402.3	471.5	421.9
NET EXPORTS	14.0	24.2	39.0	23.5	31.2	23.7	25.9	23.5	31.3	34.9	6.9	-6.9	25.2	26.1	16.6
GOVERNMENT PURCHASES	519.2	536.0	538.5	559.8	578.1	583.2	600.2	626.3	630.1	630.9	651.7	675.7	538.4	597.0	647.1
DISPOSABLE PERSONAL INCOME	1,767	1,781	1,846	1,903	1,959	1,997	2,060	2,101	2,117	2,152	2,198	2,224	1,824	2,029	2,173
PERSONAL SAVING RATE (% of disposable income)	5.5	6.1	6.1	5.5	5.4	6.1	6.5	7.5	6.6	6.7	6.9	5.8	5.8	6.4	6.5

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late January, and projected data, released by ASA-NBER in December, are displayed for fourth quarter 1982.

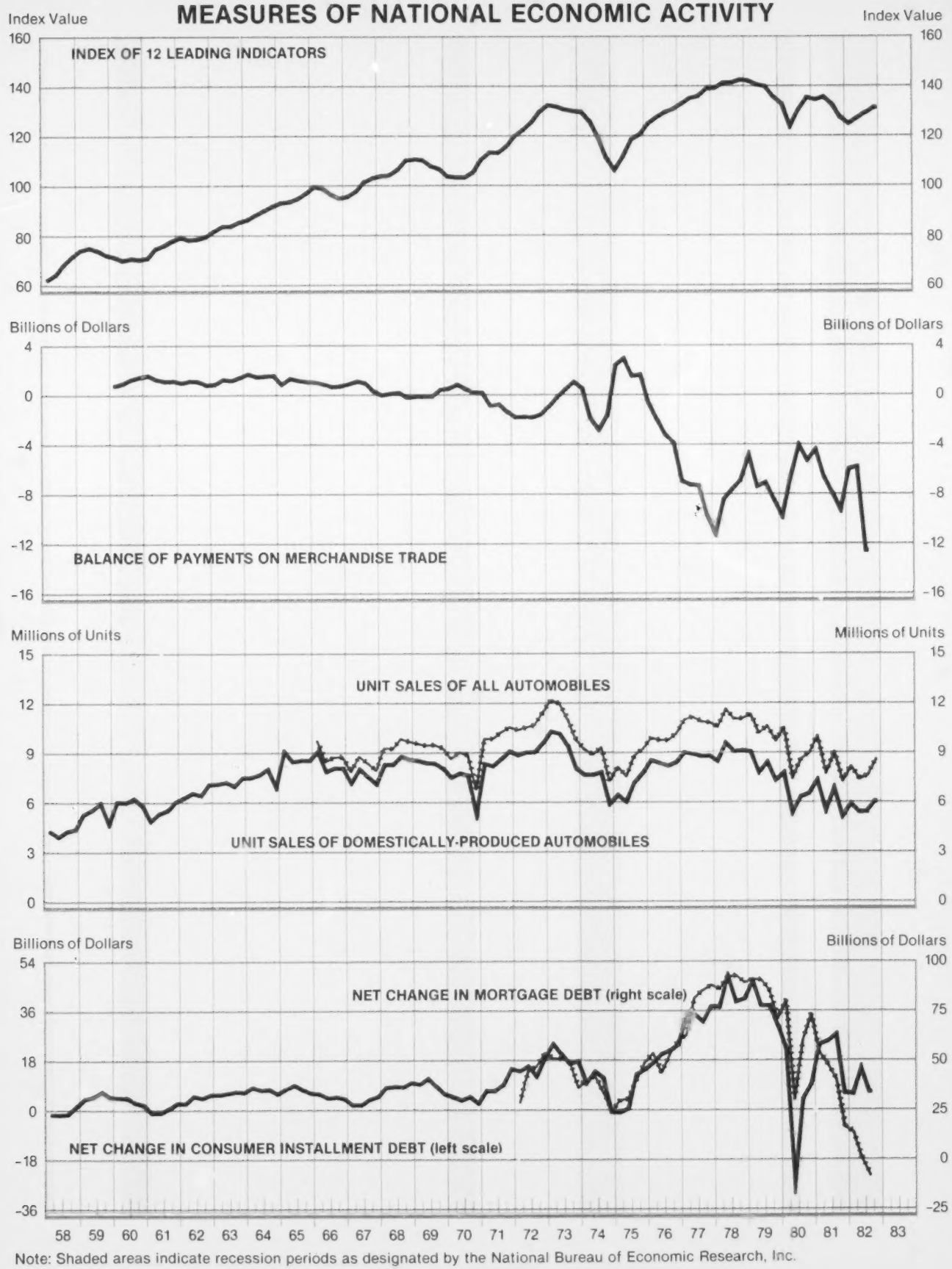
Sources: Projections: American Statistical Association – National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

SRC MEASURES OF CONSUMER ATTITUDES



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



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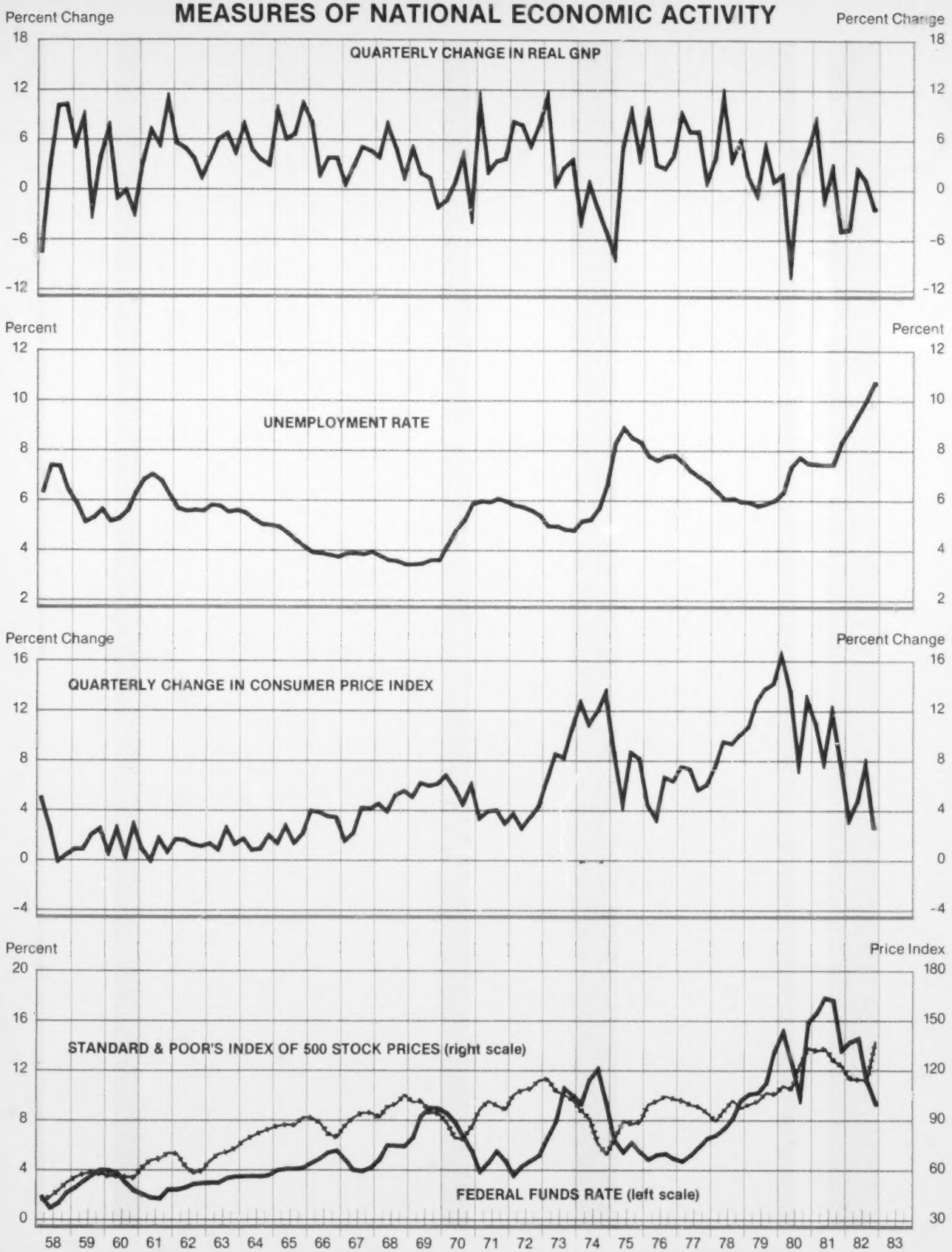
MEASURES OF NATIONAL ECONOMIC ACTIVITY



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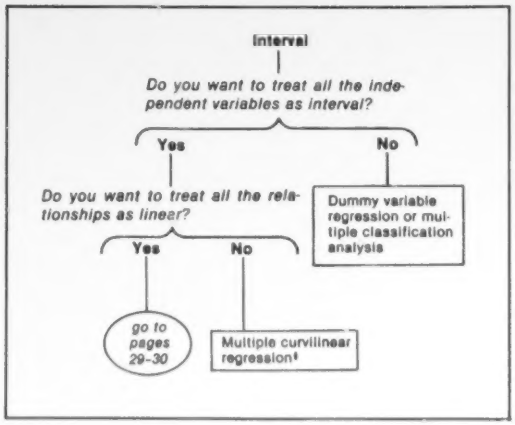
Revised and Expanded

A Guide for Selecting Statistical Techniques for Analyzing Social Science Data

Second Edition

by Frank M. Andrews,
Laura Klem, Terrence N. Davidson,
Patrick M. O'Malley, and Willard L. Rodgers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Do you want to treat all the relationships as linear?
Dummy variable regression or multiple classification analysis
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No
go to pages 29-30
Multiple curvilinear regression†

In its popular first edition, this handbook became a valuable reference tool for social scientists and data analysts in fields as diverse as psychology, sociology, economics, political science, education, public health, marketing, evaluation research, and statistics.

The substantially enlarged second edition retains most of the original material from the first edition, and adds significant new material that includes greatly expanded coverage of multivariate analysis. It presents a systematic, condensed overview of nearly 150 currently used statistics and statistical techniques and their applications.

The Guide outlines the sequence of decisions a social scientist might follow in selecting a particular statistic or statistical technique for a given analysis. The structure for this is a "decision tree"—28 pages of sequential questions and answers that lead the user to an appropriate technique. A short introduction that describes how to use the tree also suggests alternative strategies and some cautions that should be kept in mind.

For each statistic presented in the Guide a major reference is cited in Appendix A, including the specific pages on which the statistic is discussed and its means of computation given. Appendix B, which indicates where each statistic can be found in the output from computer software, has been expanded to include detailed information on sources in the OSIRIS, MIDAS, SPSS, SAS, and BMDP software systems.

A third appendix summarizes some additional statistical techniques that were judged too new or too rarely used to merit inclusion in the decision-tree portion of the Guide but that are potentially useful for social science data analysis. A glossary and thorough bibliography are also included.

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The opinions expressed in this publication represent those of individual authors and do not necessarily reflect the views of the Survey Research Center or The University of Michigan. The editor, as a matter of policy, makes no attempt to reconcile divergent opinions.

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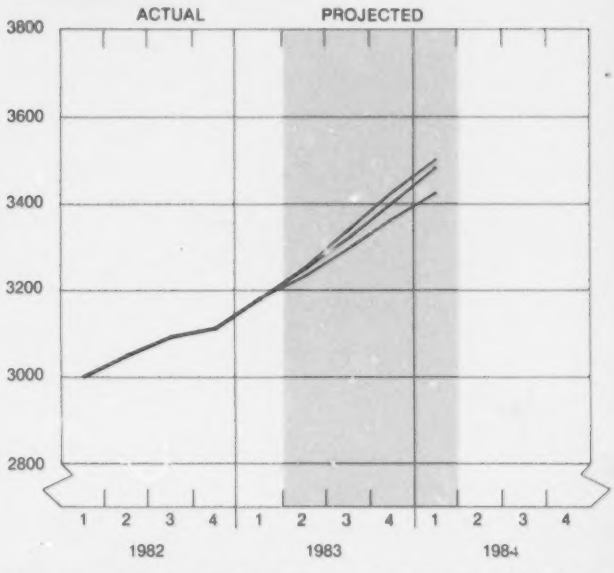

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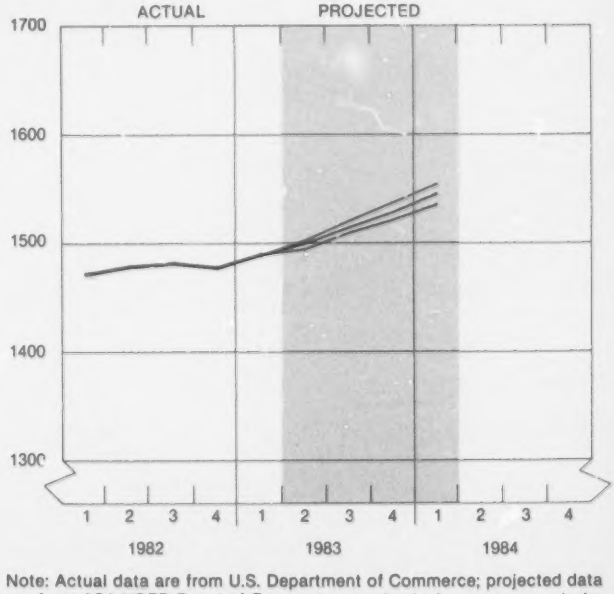

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An Urgent Task: To Reduce the Federal Budget's Structural Deficit

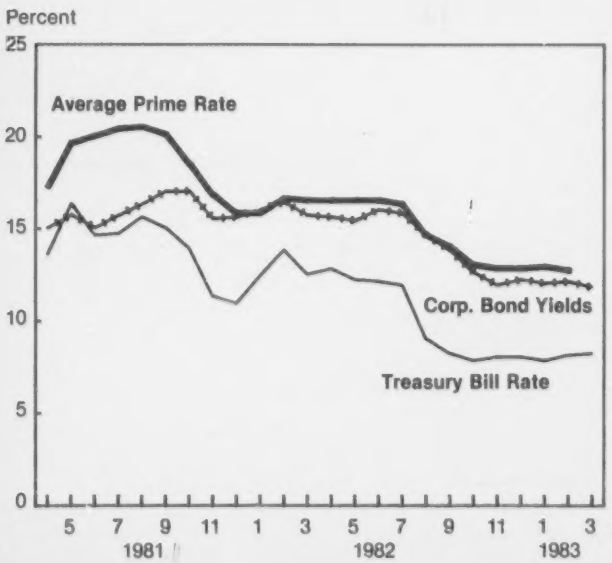
Raymond J. Saulnier
Emeritus Professor of Economics
Barnard College, Columbia University

The last time the federal budget was accorded prominence as a destabilizing factor in the economy was when it was asserted (I thought mistakenly) that the shift from deficit to surplus in 1958-59 was mainly responsible for the economy's 1959 slowing and its 1960 downturn. Today the federal budget is again thought to be the principal obstacle to achieving a good recovery (this time I think correctly), but interestingly enough not because it will turn too soon into surplus but because it will stay too long in deficit.

Interest Rates and the Recovery

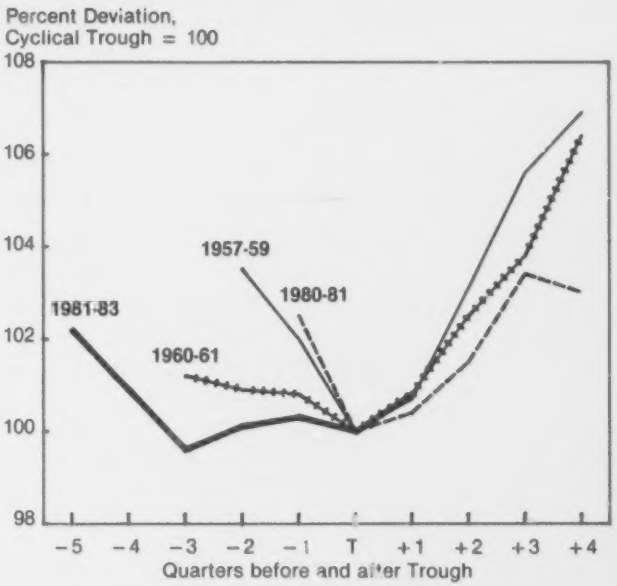
It is perhaps arguable that economics can have it both ways, but it is in any case indisputable that how the budget affects the economy depends on what happens in the monetary sphere as well as what happens to the budget. It was so in 1959-60 and will be again in 1983. Specifically, the chances of achieving a respectable recovery in 1983, and extending the advance into 1984 and beyond, will depend on interest rates, on which both the federal deficit and money policy will have a major impact. Rates have been roughly flat for a few months, after trending down for about a year (Chart 1), and official projections as well as many private forecasts have them moving down through this year. A more likely outcome, in my judgment, is that they will be higher at year-end than now. The question is whether they will be so much higher as to interrupt recovery.

CHART 1. Interest Rates, April 1981-March 1983



Source: *Business Conditions Digest,* March 1983, pp. 72-73.

CHART 2. Patterns of Recession and Recovery in Four Cycles: Constant Price GNP



Source: *Business Conditions Digest,* August 1982 and April 1983.

The risk that they will is formidable, the more especially because recovery will likely proceed more briskly than consensus forecasts suggest. The path followed by recovery in 1983:1 was broadly typical of cyclical upswings (Chart 2), and cyclical upswings are typically fairly brisk, even when they don't last long. Thus, it is consistent with what we know about the business cycle's usual behavior, as well as what can be read from current data, that nominal GNP will be up, say, 8.7 percent in 1983 over 1982. With an inflation rate (implicit price deflator) that rises 4.7 percent, which seems a reasonable assumption, real GNP would increase by as much as 3.8 percent, perhaps a bit more. Although this judgment is made strictly on the basis of conditions to date and currently in prospect, not on history, it happens that it suggests a roughly typical first-year recovery. There is, however, an atypical and scary aspect to it in what it implies for credit demand.

Credit Demands

The margin of error in such forecasts is large, but conservatively constructed estimates of aggregate credit demand—domestic and foreign, public and private—suggest that it could be 35 percent higher in 1983:4 than in 1982:4 and 20 percent higher than in that fateful period of 1981 when the prime rate went to 20½ percent and the

economy went into the first of two quickly successive recessions (Chart 3). The difficulty is not that private credit demands rebound with recovery, which they do, but that in 1983 they must be added to federal credit demands which, because they derive from a budget deficit that is largely structural, will not decline as they would if the deficit were largely cyclical. The crucial question is whether this means that a credit crunch such as occurred in 1980-81 is in the offing for 1983-84.

There is, to be sure, precisely that risk, but enough differences exist between 1983 and 1980-81 to warrant concluding that, while long-term interest rates will likely rise by year-end 1983 by 100 to 150 basis points, they are not likely to rise by the 200 or more basis points that would in all probability choke off recovery.

Inflation and the Money Supply

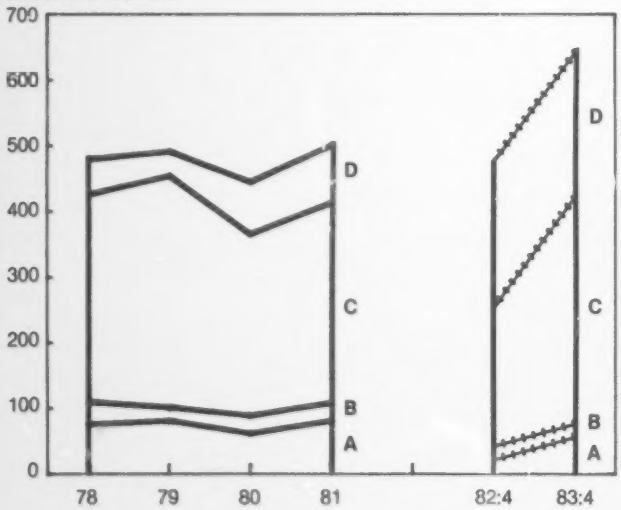
The crucial difference is the inflation rate and the inflation outlook. In 1981:1 the rate was over 12 percent in the implicit GNP price deflator, and the danger of it moving still higher was painfully apparent. Now, the inflation rate has been reduced to around 5 percent, and the labor cost and productivity factors bearing on it suggest it will stay in that area at least through this year. It was obvious in 1980-81 that money supply increases would have to be cut drastically. Whether the M1 increase had to be cut to zero, as it was between mid-1980 and mid-1981, is open to question, but the need for an unmistakably disinflationary policy was clear. M1 is again rising at roughly the 1979 rate (Table 1), but in an economy in which real output should be growing upwards of 4 percent and the rate of inflation should settle for a time between 4 and 5 percent there is no need to repeat the 1980-81 experience, and it is highly unlikely that we shall.

TABLE 1. Money Supply Increases, M1 and M2

Period	M1	M2
Twelve Months Ending in:		
December 1978	8.3%	7.9%
December 1979	15.9	7.9
December 1980	6.4	8.9
December 1981	6.4	10.1
December 1982	8.5	9.2
November 1982 to:		
February 1983		16.0
March 1983	15.8	

Source: *Economic Indicators*, March 1983, p. 16.

CHART 3. Net Borrowing in U.S. Credit Markets (Actual Data, 1978-1982:4; Estimate, 1983:4)



Note: Total net borrowing as represented by top line of chart is from

A: Financial sectors
B: Foreigners
C: Private domestic nonfinancial sectors
D: U.S. government

Sources: *Flow of Funds Accounts*, Fourth Quarter 1982, p. 51, for 1978-81 and 1982:4; R. J. Saulnier for 1983:4.

An additional difference between then and now is that net free reserves of member banks moved in twelve months in 1980-81 from around zero to a negative $2 billion. Although they have of late been again around the zero line, and could easily fall into negative ground for a time as member banks use the "discount window" to help finance recovery, that they will be allowed to drop even briefly to a negative amount as large as in 1981 seems totally unthinkable.

It is this combination of an economy recovering at close to 4 percent a year, credit demands rising to well above their 1981 amounts, and money supply increases retarded by a few percentage points that disposes me to expect interest rates to be higher at year-end than now. But the improved inflationary and monetary conditions suggest, as indicated at the outset, that the increase need not exceed 100 to 150 basis points, and need not interrupt a recovery of the dimensions sketched above.

The Deficit Problem

To achieve all this would be a highly creditable record, but because it would leave the federal budget deficit still around $200 billion, it would leave the danger of inflation-acceleration intact and threaten the need to move again at some point into another spell of monetary restraint that could turn the economy once more into recession. Accordingly, the most urgent task of economic policy in 1983-84 is to effect a significant reduction in the budget deficit.

As Chart 4 shows, the Reagan administration's budget projections have the deficit reduced by fiscal 1988 to about half its present size in absolute amount, assuming budget outlays rise by only 4 percent in fiscal 1984 and 7.2 percent

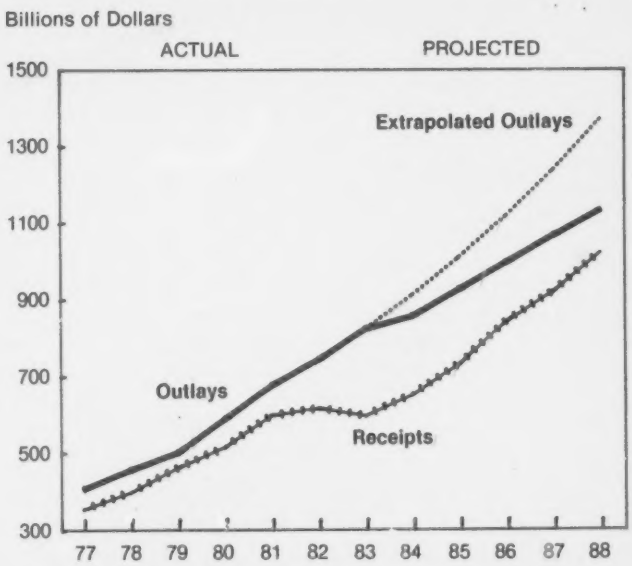
a year (compounded) in the four fiscal years 1985-88, and assuming budget receipts rise throughout roughly as expected in fiscal 1984.

The fiscal 1984 outlay assumption is probably reasonable, since recession-related items will be dropping soon out of the totals. So also is the receipts assumption. But that outlays can be held in 1985-88 to increases of 7.2 percent a year is another matter. Unfortunately, the record to date is that federal spending has been consistently higher by a wide margin than the president has proposed and projected. Increases in the fiscal years 1975 through 1982 averaged 12.2 percent, and those in FY 1985-88 will almost certainly equal the 10.7 percent officially projected for fiscal 1983 (Chart 4). This is entirely hypothetical, but it is both instructive and sobering to note, as in the course marked by the dotted line in Chart 4, that if budget outlays increase in the fiscal years 1985 through 1988 at the roughly 10.7 percent they are currently rising, the deficit in fiscal 1988 (given receipts as projected) would be roughly $350 billion!

A deficit of this size would leave the economy still vulnerable to inflation, vulnerable to another bout of severe monetary restraint, and vulnerable to yet another economic downturn. There is obviously a public policy task here of the utmost importance: to cut the rate of increase of budget outlays. And it is only through Congressional action that it can be done.

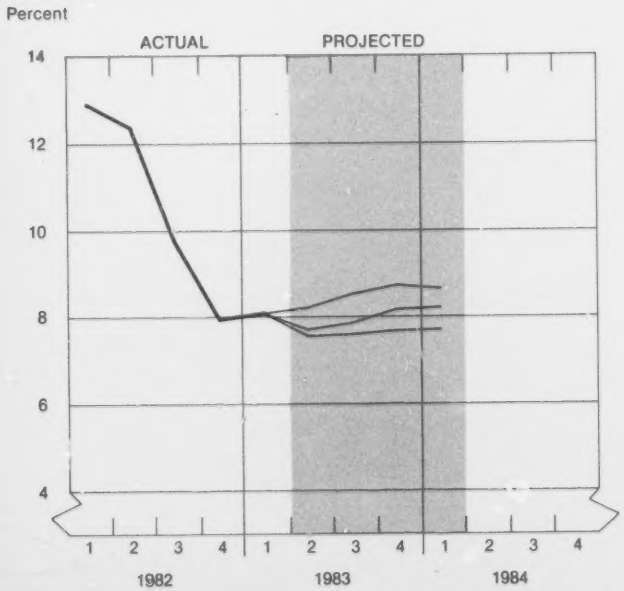
Late April 1983

CHART 4. The Federal Budget's Structural Deficit



Sources: *Economic Indicators*, March 1983, for actual data, 1977-82. *Current Budget Estimates* (Office of Management and Budget), April 1983, for projected data, 1983-88. R. J. Saulnier for extrapolated outlays, 1984-88, assuming that increases continue at the fiscal year 1983 rate, 10.7%.

90-DAY TREASURY BILL RATE



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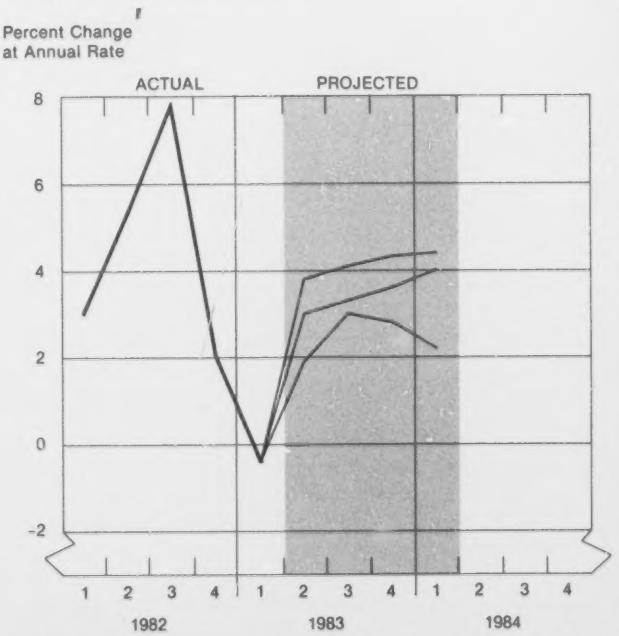

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The U.S. Economic Outlook for 1983: April Update

Saul Hymans and Joan P. Crary
Department of Economics
The University of Michigan

Recent Developments

In February preliminary data for the fourth quarter of 1982 indicated that real output had declined by 1.9 percent at annual rate. This decline resulted from an $18.7 billion (1972 dollars) drop in inventory stocks more than offsetting a $14.8 billion (or 4.1 percent annual rate) increase in real final sales. The March revision of these data reveals a smaller drop in real GNP—down 1.1 percent at annual rate. Although the inventory correction was larger, $20.3 billion (1972 dollars), the revised increase in real final sales was also greater—5.4 percent (annual rate).

The monthly data for the opening months of 1983 generally show improvement over the final months of last year. Housing starts are up. In February industrial production rose for the third consecutive month. And, non-auto retail sales (in current dollars) were flat in February after rising 0.2 percent in January. If we use the decline in the consumer price index for February as an indication of retail price movement, flat nominal retail sales in February would imply an increase in the price-adjusted level of sales for the month. The general conclusion which can be drawn from the monthly numbers is that the recovery appears to be underway but not yet charging forward. The evidence from recent consumer attitude surveys—both the Michigan (ISR) Index of Consumer Sentiment and the Conference Board index— is, however, distinctly upbeat and supports the view that the economic recovery is becoming generally more broadly based.

Inputs to the Forecast

The decisions which will be made over the next several months regarding the federal budget will have a major impact on the strength and duration of the current recovery—both in terms of the stimulus provided to the economy by a budget which is in deficit and in terms of the potential effect on interest rates of expectations regarding "out-year" deficits.

The federal expenditure levels in our forecast fall short of the official projections by about $9 billion and $15 billion in fiscal '83 and '84 respectively. The difference for the current fiscal year is the sum of small shortfalls in most categories other than interest payments and includes minor adjustments for lower fuel prices. For fiscal '84 the $15 billion difference can be traced to three principal factors: $4 billion less in transfer payments resulting from the more rapid economic expansion which underlies our budget assumptions, $13 billion less in defense spending, and about $2 billion more in interest payments. The administration is projecting increases in defense spending of about 15 percent per year for fiscal '83 and '84. We are assuming that defense spending will rise by about 14 percent and 10 percent in fiscal '83 and '84 respectively. These correspond to real increases of about 7½ percent and 5 percent in the respective fiscal years (again, assuming no federal pay increase in fiscal '84) and are, in our judgement, more likely to approximate what the Congress will provide.

On the revenue side of the federal budget, our forecast is based on existing tax laws, including the recently-passed Social Security package. Already on the books are many other changes in federal tax laws which are scheduled to become effective over the next two years. The Economic Recovery Tax Act of 1981 (ERTA) will continue to reduce taxes through the extension of existing tax breaks and the third phase of the personal tax cut effective July 1, 1983. We estimate that ERTA will reduce tax revenue by an additional $47 billion in FY '83 and a further $41 billion in FY '84.

Offsetting some of the ERTA tax cuts are the tax increases embodied in the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). By withholding taxes on interest and dividends, tightening the enforcement of both personal and business taxes, and an assortment of other provisions, TEFRA is projected to increase revenues by an additional $23 billion in fiscal 1983 and another $17 billion on top of that in fiscal 1984.

The final revenue enhancement on the books is the five-cent-per-gallon gasoline tax increase which took effect on April 1, 1983. It is expected to generate $2.8 billion during the current fiscal year and $5½ billion in fiscal 1984.

The net effect of all these tax policies is to reduce revenues by an additional $21 billion in fiscal 1983 and another $12 billion in fiscal 1984.

These budget policy assumptions along with our forecast generate a federal deficit on a National Income and Project Account basis of $183.1 billion for fiscal 1983. In fiscal 1984 the deficit is projected to decline to $156.5 billion with the deficit declining on a quarterly basis throughout the fiscal year.

The Federal Reserve is committed to a monetary policy which supports economic recovery without refueling inflation. We believe that in the context of the federal budget which we have assumed for our forecast such a policy would include allowing the monetary base to grow at an average rate of 6 percent during the rest of 1983 and 5½ percent during 1984.

The effort to keep price increases within a tolerable range will be aided by both farm and oil price behavior. We have projected average increases in farm prices of 3½ percent during 1983 and 5½ percent during 1984 as weak world demand and adequate supply place little upward pressure on farm prices. We have assumed that the recent OPEC agreement will not result in any further substantial decreases in the world price of oil, with the price remaining

flat until the fall. Thereafter, oil prices should rise slowly, with the rate of price increase during 1984 averaging less than 4 percent.

We are anticipating continued weakness in the volume of U.S. exports. In real terms, exports declined by 6 percent in 1982:4. We are projecting a further decline of 7 percent in the current quarter, to be followed by a slow recovery to an annual growth rate of 3 percent by the second half of 1984.

The Forecast for 1983-84

We now estimate that real output grew at a 3 percent annual rate in the first quarter of this year. For the rest of the year we are forecasting continued growth with the rate of growth of real GNP peaking at 6.5 percent (annual rate) in the third quarter. Real output is forecast to continue to increase during 1984 but at a decreasing rate averaging 4.6 percent (annual rate) during the last half of the year (Chart 1).

Auto sales, after remaining fairly flat in the first quarter, are forecast to improve slowly in the spring and more substantially in the second half of 1983. By 1983:4 we project car sales of 9.4 million units (annual rate). Steady improvement is forecast for 1984, with car sales averaging 10 million units for the year as a whole (Chart 2).

Although the month of March is expected to show some drop-back in the level of housing starts compared with January and February, we expect that starts will begin to move up again in the spring. We are forecasting that housing starts will average 1.7 million units for 1983 and 1.9 million for 1984—up from a 1982 average of just over a million starts (Chart 2).

Real business capital spending will continue to decline through the spring, followed by growth during the second half of 1983 at a 10.2 percent annual rate. In 1984 real capital spending will be up by almost 14 percent over the 1983 level (Chart 1).

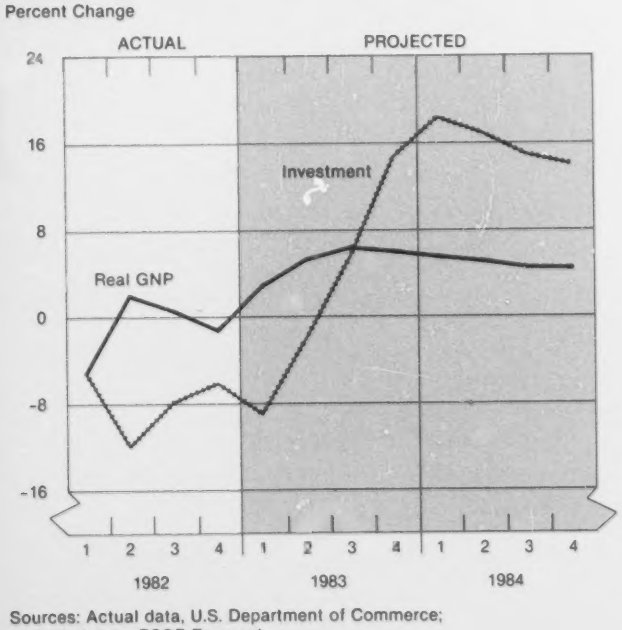
The increasing level of economic activity should yield a steady decline in the civilian unemployment rate from the current 10.3 percent. The unemployment rate is forecast to drop below 10 percent in the third quarter and to average 9½ percent for 1983:4. With continued economic growth during 1984 the unemployment rate is projected to fall to 8 percent by 1984:4 (Chart 3).

After rising slightly over the past few weeks, interest rates are forecast to remain fairly steady over the next 3-6 months and then to decline slightly, with the 90-day Treasury bill rate staying in the 8-8¼ percent rate throughout 1984 and the Aaa corporate bond rate staying in the 11-11½ percent range (Chart 4).

The rate of inflation is forecast to remain moderate throughout 1983-84. With more normal increases in energy prices and general tightening of markets, a slight increase in the inflation rate is predicted for 1984 (Chart 3).

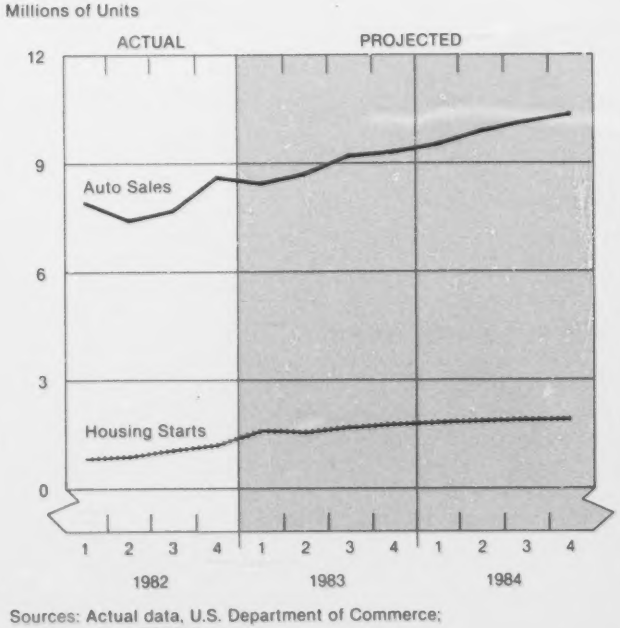
The principal economic indicators in our 1983-84 forecast are summarized in Table 1.

CHART 1. Annual Rates of Growth of Real Gross National Product and Business Fixed Investment (1972 dollars)



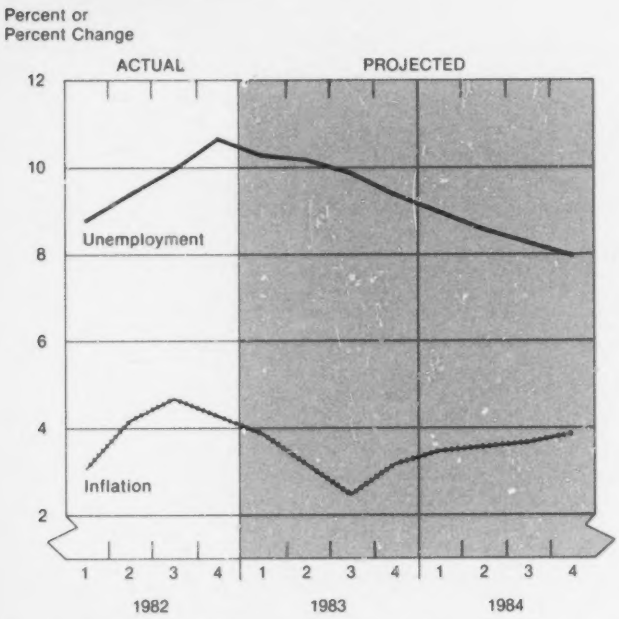
Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 2. Automobile Sales and New Private Housing Starts



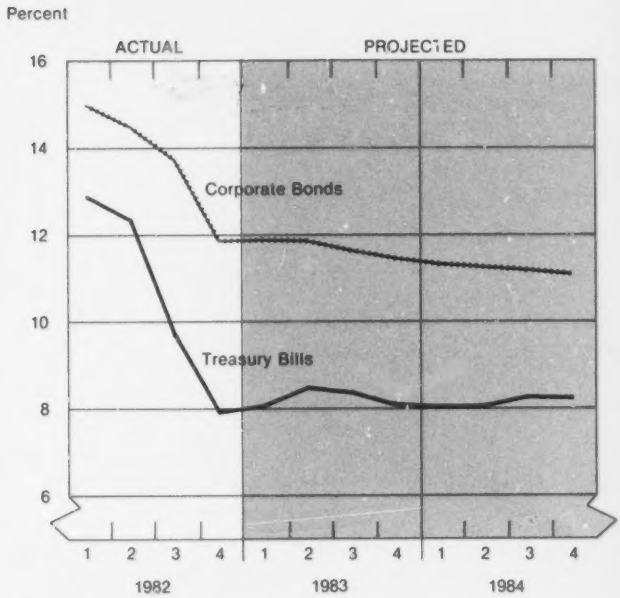
Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 3. Unemployment Rate and Annualized Inflation Rate (Private Nonfarm Price Deflator)



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 4. Interest Rates for 3-Month Treasury Bills and Corporate Aaa Bonds



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

TABLE 1: Michigan Model Forecast for 1983-84

	Actual		RSQE Forecast	
Economic Indicator	**1981**	**1982***	**1983**	**1984**
GNP (billions of current dollars)	2937.7	3059.3	3281.1	3616.9
Inflation (GNP deflator, percent change)	9.4	6.0	4.1	4.4
Real GNP (billions of 1972 dollars)	1502.6	1476.9	1521.0	1606.2
Percent Change of Real GNP	1.9	-1.7	3.0	5.6
Civilian Unemployment Rate (percent)	7.6	9.7	10.0	8.5
Capacity Utilization, Manufacturing (percent)	78.5	69.8	71.2	77.7
Automobile Sales (millions of units)	8.5	8.0	9.0	10.0
Private Housing Starts (thousands of units)	1100	1059	1700	1904
90-Day Treasury Bill Rate (percent)	14.0	10.6	8.3	8.2
Aaa Corporate Bond Rate (percent)	14.2	13.8	11.7	11.2
Real Disposable Income (billions of 1972 dollars)	1043.1	1054.8	1069.8	1100.9
Percent Change of Disposable Income	2.5	1.1	1.4	2.9
Corporate Profits before Tax (billions of current dollars)	232.1	175.6	211.5	270.2
Federal Deficit (Fiscal Year, billions of current dollars)	50.8	120.7	183.1	156.5

*Preliminary data.

The Deficit and the Money Markets

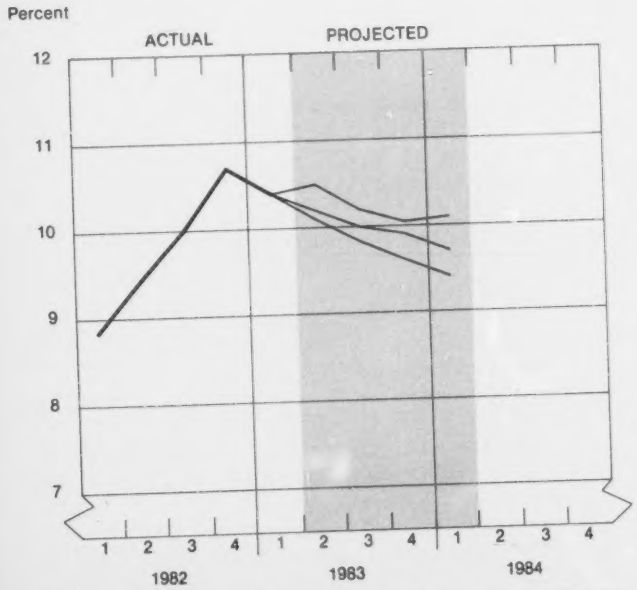
The federal budget deficit is forecast to drop fairly sharply as the economy expands over the next two years and the tax and expenditure assumptions discussed earlier take hold. The forecast deficit path implies that the federal government's financing requirements will be decreasing as private credit demands increase during the next two years. Further, the pattern of declining deficits should establish itself by the middle of this year. If the financial markets perceive this to be an indicator of the underlying trend in the federal deficit, the economic recovery should develop with no out-year deficit complications affecting interest rates. But—as noted in our discussion of budget assumptions—the deficit trend in our forecast is predicated on a lower level of federal expenditures than the administration is seeking for fiscal 1984. In addition, the trend shown in our forecast will not continue beyond fiscal '84 unless some action is taken to offset the revenue losses which will be generated by the automatic indexation of the tax system currently scheduled to begin in fiscal '85.

It is the apparent sense of the Congress—and of public opinion as revealed in the polls—that the recent tax cuts along with the prospective tax reductions and the defense build-up contained in administration plans is simply inconsistent with winding down the long-term budget deficit. That appears to be exactly right. In the coming year the Congress will have to act to reduce the excessive stimulus implied in the proposed out-year budgets. Without such action, the only likely outcomes are a return of high inflation, sharply higher interest rates, or both.

The U.S. economy does not benefit when excessive reductions in federal revenue capability merely force state and local governments to compensate by increasing their own tax rates—a pattern which has developed in the past several years. Nor does the economy benefit when the federal budget produces a circumstance which forces the private economy to operate in a high interest rate regime as it did during much of 1981 and 1982.

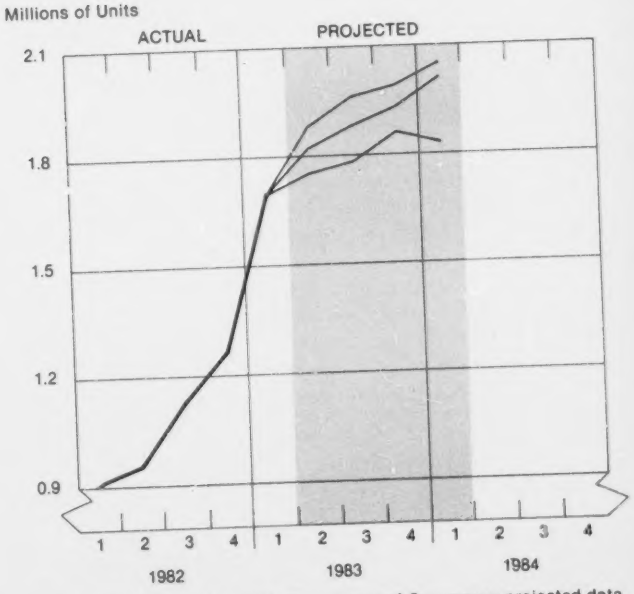
Early April 1983

UNEMPLOYMENT RATE



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

NEW PRIVATE HOUSING UNITS STARTED



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Surge in Consumer Optimism

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Widespread Improvement

In the April 1983 survey, the Index of Consumer Sentiment was 89.1, up from 80.8 in March and 70.4 in January 1983.[1] This three-month surge of nearly 20 Index points has brought consumer confidence to the highest level recorded since the cyclical peak of 89.8 was reached in May 1977. Among families with incomes of $20,000 or more, the Index rose to 97.1 in the April 1983 survey, from 88.4 in March and 78.2 in January. In comparison with year-earlier readings, gains of 20 Index points were recorded by residents of each major geographic region, and among all age and income subgroups.

The Most Widely Anticipated Recovery

Since the start of 1983, consumers have reported significant improvement in the current state of the economy. The proportion of families that reported the economy had improved rose to 51 percent in April from 16 percent in January, while the proportion of families that thought the economy had worsened fell to 38 from 76 percent. Expected changes in the economy during the year ahead, which were already favorable at the start of 1983, have now risen to all-time record levels. Among all families, 53 percent expected business conditions to improve during the year ahead, the highest level recorded in a quarter century. Just 7 percent of all families expected worsening business conditions in the April 1983 survey. When asked why they expected the economy to improve, consumers cited favorable trends in employment, interest rates, and prices.

Although economic improvement in the near term was expected by record numbers, many fewer families expected the reestablishment of good times financially in the economy as a whole over the longer term. Among all families, 38 percent expected good times in the economy as a whole during the next five years, up from 26 percent in January 1983. Similarly the proportion of all families expecting bad times in the economy over the longer term declined to 39 percent from 57 percent three months earlier. Although more families expected good times over the longer term than at any other time during the prior decade, long-term optimism remained in the April 1983 survey significantly lower than that recorded during the 1950s and 1960s.

[1]This article departs from the standard practice of reporting on trends in quarterly averages since this would have obscured the dominant upward monthly trend. The accompanying Index of Consumer Sentiment chart and the charts on page 45 show trends in quarterly averages, with the last point plotted being the average value for the first quarter 1983 surveys. As a result, these charts do not reflect the rapid pace of improvement nor the more favorable April data.

Employment and Inflation Outlook Improves

At the start of 1982, when the national unemployment rate stood at the already high level of 8.7%, half of all American families expected the unemployment rate to rise even further. By mid-1982, half of all families reported hearing news of plant closings, layoffs, and other increases in unemployment. Yet by the first quarter of 1983, when the national unemployment rate stood at 10.2%, families more frequently expected declines rather than increases in the unemployment rate for the first time since 1977.

News heard and recalled by consumers of recent economic developments was more favorable in the April 1983 survey than at any other time during the prior quarter century. More than twice as many favorable as unfavorable developments were reported (76 versus 32 percent). Reports about increases in employment rose to 29 percent in April 1983, from 12 percent in January, and were higher than at any other time during the past 25 years. News of increases in unemployment fell to 20 percent in April 1983, from 43 percent at the start of the year. In addition to reporting recent improvements in unemployment, the respondents in the April 1983 survey also expected more favorable trends in the year ahead. Among all families, 42 percent expected the unemployment rate to decline during the year ahead, up from just 23 percent in January, and just below the all-time record level of 44 percent recorded in 1966. Just 15 percent of all families expected unemployment to increase during the year ahead in April 1983, half the level recorded just three months earlier.

Consumers expected the annual rate of inflation to average 4.3% in the first quarter 1983 surveys, down from 5.7% one year earlier, and substantially below the peak rate of 11.9% recorded in the first quarter of 1980. Long-term price expectations have also declined during the past several years, and by the first quarter of 1983 consumers expected the annual inflation rate to average 5.8% during the next 5 to 10 years. From 1979 to 1981, the inflation rate expected during the following year was higher than the rate consumers expected over the next 5 to 10 years. In contrast, in 1982 and 1983 short-term price expectations have been lower than the expected long-term average.

Although fears of spreading unemployment have eased, unemployment remains an important concern of consumers. In the April 1983 survey, consumers still judged unemployment rather than inflation to be the more serious economic problem facing the nation by a margin of 73 to 20 percent. Concern with unemployment as the more serious economic problem has remained at record levels throughout the past year.

Confidence in government economic policies to reduce unemployment and inflation rose sharply in the April 1983 survey from the lowest level reached during the Reagan administration, recorded two months earlier in February. The proportion of families that rated government economic policies as poor fell to 24 percent in April from 41 per-

cent in February. The proportion of families that rated economic policies as good rose to only 21 from 16 percent, while the proportion of families that rated government policy as fair rose to 53 percent in April 1983 from 40 percent in February. On balance, consumer confidence in government economic policies was restored to the higher levels recorded at the start of 1982.

Sharp Improvement in Personal Finances

In the April 1983 survey, American households more frequently reported favorable than unfavorable changes in their financial situation for the first time in nearly five years. Among all families, 39 percent reported improved personal finances in April, up from 31 percent in March, and just below the cyclical peak of 40 percent reached in 1978. In comparison, unfavorable recent changes in personal finances were reported by 31 percent of all families in April, down from 39 percent in March, and just above the low of 27 percent recorded in 1978. Although the recent improvement nearly restores personal financial attitudes to the favorable levels recorded in the late 1970s, these evaluations remained significantly below the levels recorded in the prior two decades. When asked to explain how their financial situation had changed, respondents in the April 1983 survey less frequently mentioned income declines than one month earlier (19 down from 26 percent) and less frequently mentioned the adverse impact of inflation on family budgets (18 percent—the lowest level recorded during the last decade).

More families in the April 1983 survey expected their financial situation to improve during the coming year than at any other time during the last decade. Among all families, 40 percent expected their financial situation to improve during the year ahead, a larger proportion than recorded at any time during the decade of the 1970s, but below the peak of 46 percent recorded in 1964. Just 9 percent of all families expected their financial situation to worsen in the April 1983 survey, somewhat above the 5 percent all-time record low.

Fewer families expected their money income to decline in April 1983 (10 percent) than one month earlier (17 percent) or one year earlier (18 percent). Compared with a year earlier, income increases of less than 10% were more frequently expected by families in the April 1983 survey (33 up from 25 percent), while the proportion of families that expected income increases of 10% or more remained unchanged (at 26 percent). These modest increases in income expectations coupled with declines in expected inflation have led to the most favorable real income expectations recorded during the last decade. Two-thirds of all families reported in the April 1983 survey that they expected their family income to keep pace with or exceed the annual rate of inflation.

Favorable Buying Attitudes Dominate

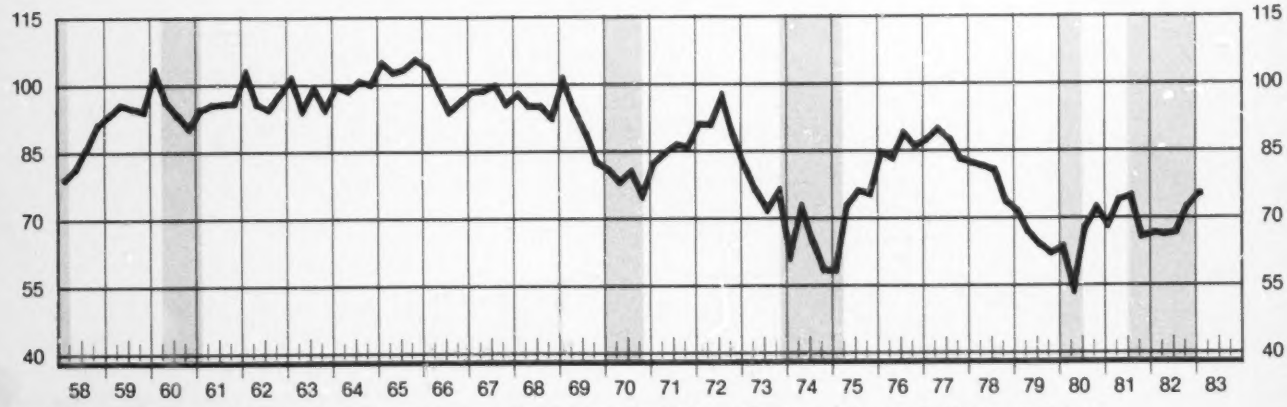
The April 1983 survey continued to record rapid improvement in attitudes toward buying conditions. Due to declines in prices and interest rates, the majority of American households now view buying conditions favorably for cars (66 percent), houses (61 percent), and large household durables (61 percent). During the past year, the proportion of families holding favorable buying attitudes increased by 41 percentage points for houses, 26 percentage points for cars, and 20 percentage points for household durables.

Two-thirds of all American families held favorable car-buying attitudes in the April 1983 survey, a new all-time record high level. Moreover, the April survey marked the third consecutive month that a new record level was set. During the 1950s and 1960s, peak levels often reached 50 percent, but never exceeded 55 percent prior to 1983. Unfavorable evaluations of market conditions for cars, however, are also more prevalent now than two decades earlier: in comparison with the 29 percent that rated car market conditions unfavorably in April 1983, in the 1950s and 1960s this figure reached a low of 10 percent.

The proportion of American households that held favorable attitudes toward buying conditions for houses was 61 percent in April 1983, up from 51 percent in March, and just below the peak level of 63 percent recorded in May 1977. Although the current level is similar to the 1977 peak, the price rationales underlying the favorable at-

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

titudes have shifted from the fear of rising prices to the appeal of lower prices. When the 1977 peak level was reached, 47 percent of all respondents mentioned buy-in-advance price rationales for their favorable attitudes; in the April 1983 survey, only 7 percent mentioned buy-in-advance price rationales. In 1977 just 4 percent of all families mentioned the availability of lower prices and good housing buys; in the April 1983 survey, 24 percent of all families mentioned the appeal of lower housing prices – higher than at any time during the 1960s and 1970s.

The impact of interest rates on buying attitudes has changed dramatically since mid-1982. At that time record numbers of families complained about high interest rates charged on consumer purchases. By April 1983, in sharp contrast, record numbers of consumers mentioned the availability of lower interest rates. With regard to the housing market, the proportion of families that complained of high interest rates fell from 82 percent in July 1982 (an all-time peak) to 24 percent in April 1983, while references to the availability of lower mortgage rates rose from 4 percent in July to 54 percent in April 1983 (an all-time peak). When asked to evaluate market conditions for automobiles, consumer complaints about high interest rates fell from 32 percent in July 1982 (an all-time peak) to 11 percent in April 1983, while references to the availability of lower interest rates rose from 5 to 40 percent in April 1983 (an all-time peak).

Recent declines in interest rates have already reduced the backlog of postponed purchases. The proportion of families that reported they had postponed purchases due to high interest rates fell to 23 percent in the April 1983 survey, down from a high of 36 percent in mid-1982. The most frequently postponed purchases continue to be vehicles (10 percent), followed by household durables (7 percent) and houses (5 percent). The highest interest rate that consumers would have been willing to pay on the postponed purchases was approximately equal to 11% each for vehicles, houses, and household durables, while the median interest rate that would have been charged on these purchases was nearly 2 percentage points higher for household durables than for vehicles and houses. Consequently, credit purchases of household durables were more likely to be resisted, largely due to the failure of interest rates charged on credit cards to decline.

Fewer families expected interest rates to decline in the year ahead in the April 1983 survey (34 percent) than either one month earlier (41 percent) or one year earlier (42 percent). Interest rate increases were expected about as frequently in April 1983 (21 percent) as one year earlier (22 percent), while the proportion of families that expected interest rates to remain unchanged at current levels during the year ahead rose to 42 percent from 33 percent one year earlier. Despite the small decline in favorable interest rate expectations, these expectations remain near record favorable levels.

Financing the Recovery

A sustained economic recovery requires greater access to and use of loanable funds. Consumers need funds to finance increased purchases of houses, cars, and household durables; businesses need investment funds to expand and modernize; and the government needs funds to finance budget deficits. A total of $408 billion was raised in the U.S. credit markets by the domestic nonfinancial sectors during 1982. The total amount borrowed in credit markets rose rapidly during the 1970s – from just under $100 billion in 1970 to just under $400 billion in 1979. From 1979 through 1982, the total amount of funds raised in the U.S. credit markets remained largely unchanged, at about $400 billion. In constant 1972 dollars, the total amount of funds raised in U.S. credit markets has fallen from a peak of $245.1 billion in 1978 to approximately $200 billion from 1980 to 1982.

While the total nominal dollars raised in credit markets have remained largely unchanged, the share of funds raised by the government sector has risen dramatically. During 1982 the government sector (primarily the federal government) borrowed $208.5 billion, $100 billion more than in 1981. Consequently, in 1982 the government sector borrowed 51 percent of all funds raised in U.S. credit markets. A 51 percent share replicates the prior peak level recorded in 1975; aside from 1975 and 1982, in no other year during the past three decades has the government sector share exceeded 40 percent. Household borrowing accounted for just 21 percent of all funds raised in 1982, the lowest share recorded since 1952 (see Table 1).

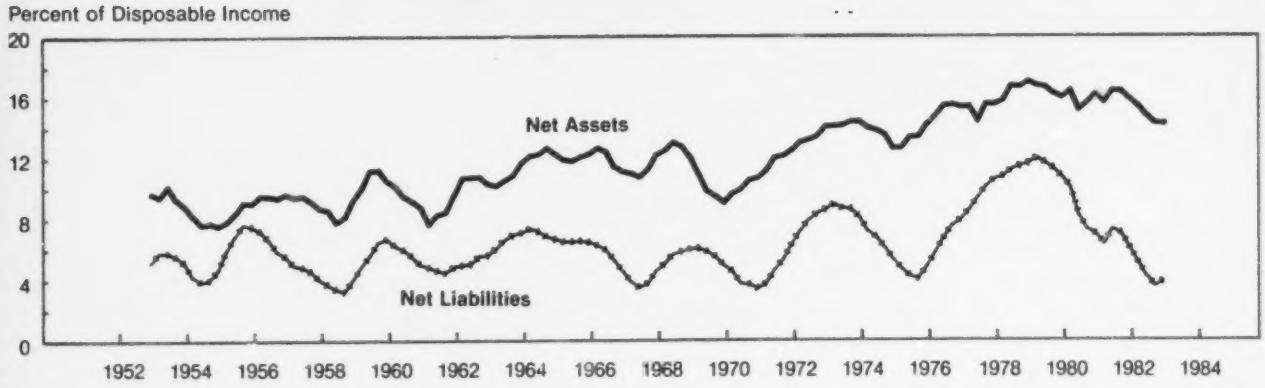
Greater borrowing by the consumer and business sectors must come either from decreases in government sector borrowing or from increases in the total amount of funds raised. To an important extent shifts in the amount of funds raised by the private sectors and the funds raised by the government sector are interrelated. As the economy improves and consumers and businesses increase credit market borrowing, the increase in economic activity also acts to lower government deficits and hence their credit market borrowing. In past years, however, these effects were rather small in comparison to increases in the total

TABLE 1: Share of Funds Raised in U.S. Credit Markets by the Nonfinancial Sectors

Sector	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Government	25%	31%	18%	11%	15%	51%	34%	23%	20%	15%	30%	28%	51%
Nonfinancial Business	48	37	42	47	54	22	29	34	34	40	37	41	28
Households	27	32	40	42	31	27	37	43	46	45	33	31	21
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Addendum:													
U.S. Government	13%	18%	9%	4%	7%	44%	28%	18%	15%	10%	22%	22%	40%

Source: Federal Reserve Board

CHART 1. Net Acquisition of Financial Assets and Liabilities as a Percent of Income (Four-Quarter Moving Averages)



amount of funds raised. Following the 1974-75 recession, government sector borrowing fell from $99 billion in 1975 to $72 billion in 1977. In comparison with the rather modest decline in the dollar amounts raised, the share of funds raised by the government sector fell from 51 percent in 1975 to 23 percent in 1977.

Consumer saving is the major source of funds for the U.S. credit markets. During the past year, the rate of both financial asset and debt acquisition by consumers declined, but the incurrence of debt declined to a much greater extent and thus led to an improvement in the net savings rate (see Chart 1). From 1979 to 1982, the net saving rate more than doubled, rising from under 5% to 10.4%—higher than at any other time in the last 30 years.

This increase in financial saving is based on data derived from the Federal Reserve Board's Flow of Funds Accounts. Another more widely used measure of consumer saving based on the National Income and Product Accounts (NIA) would not support similar conclusions (see Chart 2). In sharp contrast to the FRB saving rate, from 1977 to the present the NIA saving rate has remained in the 5 to 6 percent range, a level only reached at cyclical low-points during the preceding quarter century. Thus, the NIA saving rate would appear to indicate that the saving habits of American consumers have changed drastically. In the early 1950s, the NIA saving rate was approximately 4 percentage points higher than the FRB saving rate. During the 1960s and 1970s, the NIA saving rate was generally above the FRB rate, but the difference was relatively small. In contrast, the FRB saving rate exceeded the NIA rate by 4 percentage points by 1982. Although the recent divergence is consistent with the long-term trend, at no time during the past 30 years has the difference been so large. At present, the difference amounts to $83 billion: $143 billion was saved when estimated according to the NIA procedure in 1982, compared with $226 billion based on the FRB procedure (see Table 2).

How can this divergence be explained? It is of course true that the two savings measures are based on distinct approaches that defy exact reconciliation. Both methods calculate consumer savings as a residual. The FRB accounts may have allocated too few dollars to the business and foreign sectors, and thus overestimated consumer savings. Or the problem may lie in the underestimation of personal disposable income in the NIA accounts, which are based on IRS data. If NIA personal disposable income is underestimated, it would not only cause NIA savings to be underestimated, but also cause the FRB saving rate to be

CHART 2. Personal Saving Rate—NIA and FRB Bases (Four-Quarter Moving Averages)

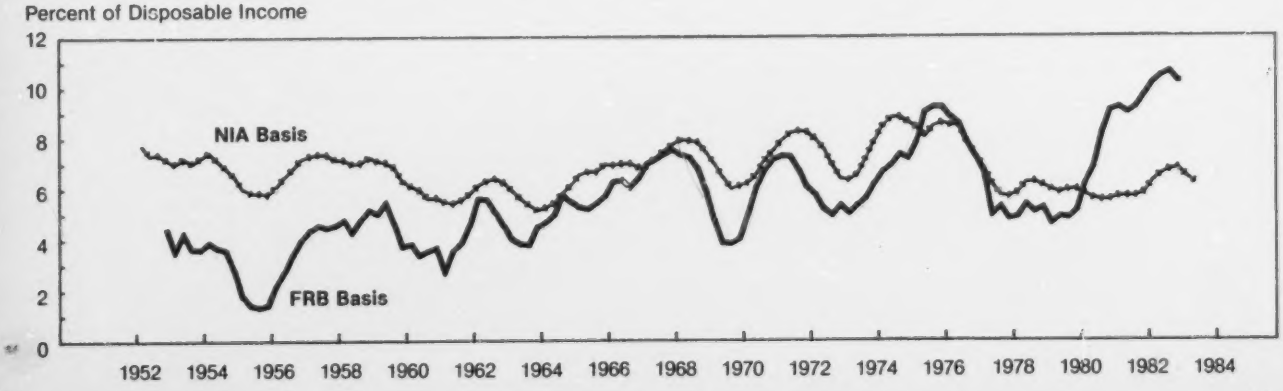


TABLE 2: NIA and FRB Household Savings (Billions of Current Dollars)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
FRB Savings	50.7	46.2	44.2	58.1	73.2	102.1	87.9	64.5	78.6	86.6	168.2	199.5	225.6
NIA Savings	55.8	60.7	52.6	79.0	85.2	94.3	82.5	80.0	89.4	96.7	106.2	130.2	142.8
Difference	-5.1	-14.5	-8.4	-20.9	-12.0	7.8	5.4	-15.5	-10.8	-10.1	62.0	69.3	82.8

Source: Federal Reserve Board

overestimated (since the income base should have been larger). At the present time, it is unclear whether one or both of these hypotheses is correct. But until the divergence in the NIA and FRB data is better understood, analysts must view both sets of savings data with greater skepticism than usual.

Will there be adequate funds to finance a sustained recovery in consumer sales during 1983? In view of the savings data inadequacies, doubt remains concerning the amount of personal savings which will be generated to cover increased debt demands. Judgments on the ability of the current mix of economic policies to raise the level of personal savings will differ depending on the data source used, as will judgments on which alternative policies should be pursued. Given the record levels of government sector borrowing, a reduction in the federal deficit represents the most direct method to accommodate significant increases by the consumer and business sectors, without exerting upward pressure on market interest rates.

Summary Outlook

A robust recovery in sales of vehicles and houses during 1983 will not want for lack of favorable consumer attitudes and expectations. The rapid improvement recorded since the start of 1983 has been widespread across all aspects of consumer sentiment as well as across all major population subgroups. The most favorable aspects of consumer sentiment reflect the expected direction of *change* in the economy, not the expected *level* of economic performance. The record number that expected improvement also reflects the length and depth of the past recession. Nonetheless, by any standard, consumers are now optimistic. Declines in prices and interest rates have stimluated very favorable attitudes toward buying conditions for vehicles and houses. The pace and length of the recovery will depend not on further changes in the willingness of consumers to make large discretionary purchases, but rather on the ability of consumers to finance significant increases in their purchases of vehicles and houses without a resurgence in interest rates.

May 1983

Results from the February NABE Survey

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Another survey of National Association of Business Economists (NABE) members was conducted in February. As reported in the Winter 1983 issue of OUTLOOK, these quarterly surveys solicit forecasts of various economic series and opinions about current economic policy matters.

Economic Forecasts

Table 1 displays median values of forecasts for selected economic series asked about in February. Real GNP was expected to increase by about 4 percent from 1982:4 to 1983:4, consumer prices were expected to increase by about 5 percent during the same four-quarter period, and real fixed investment was forecast to remain essentially unchanged. Other questions not displayed in the table indicated that the rate of increase of both GNP and prices was expected to be greater in the second half of 1983 than in the first half. And, the long-run inflation rate (CPI rate for the next decade) was placed at slightly over 6 percent, only a bit down from projections given in the May and August surveys of last year. Thus, as of February longer-run price expectations seemed not much influenced by the very substantial cooling of inflation during the past year or so.

NABE forecasters saw the unemployment rate as being just below 10 percent by the end of the year, with the prime rate at about a percentage point higher. New private housing starts were expected to average about 1½ million units during the fourth quarter, and auto sales were to be around 9½ million units then (both quantities at annual rates).

Fiscal and Monetary Policy

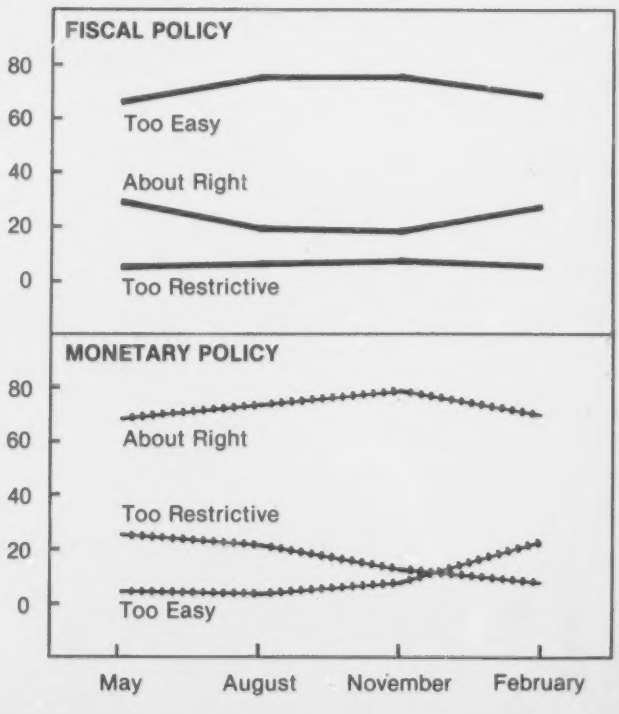
Several questions concerning fiscal and monetary policy were included in the February survey. Chart 1 displays the trend in opinions about the relative looseness/tightness of fiscal and monetary policy for the four surveys conducted to date. In each survey respondents were asked, "Do you think *monetary policy,* as you see it being implemented now, is too easy, too restrictive, or about right?" and "Do you think *fiscal policy,* as you expect it to be implemented during fiscal years 1983 and 1984, will be too easy, too restrictive, or about right?" The gradual trend, noted in the Winter 1983 article, toward the "too easy" view of monetary policy had accelerated substantially by February, with almost a quarter of respondents then holding that view. Still, 70 percent believed that monetary policy was being implemented "about right" in February. Opinions about fiscal policy were about back to where they were last May, indicating, as compared with the August and November surveys, some shift away from the "too easy" category toward the "about right" one.

Respondents were asked several questions about administration budget projections in the February survey. One question called for an evaluation of budget projections for fiscal year 1984. While more than half the NABE respondents thought the actual deficit would be within $20 billion of administration projections, approximately twice as many thought the deficit would be substantially *less* than the projections as thought it would be substantially

TABLE 1: Forecasts of Selected Economic Series

Series	Median Value
Annualized Percent Change:	
Real GNP, 1982:4-1983:4	3.8
Consumer Price Index, 1982:4-1983:4	5.0
Real Fixed Investment, 1982:4-1983:4	0.2
Percent:	
Unemployment Rate, 1983:4	9.9
Prime Rate, 12/31/83	10.9
Millions of Units:	
New Private Housing Starts, 1983:4	1.5
Automobile Sales, 1983:4	9.6

CHART 1: Opinions about Fiscal and Monetary Policy, May 1982-February 1983



greater. This seems consistent with the more general feeling that administration budget projections released earlier this year perhaps erred on the conservative side (i.e., overestimated expenditures and underestimated revenues). Concerning longer-run projections, only about a third of respondents believed realistic the outlay and revenue assumptions underlying forecasts of declining deficits between fiscal years 1985 and 1988. The other two-thirds split almost equally when asked whether the deficits were likely to be larger or smaller than the administration's predicted values. Only about a fifth of all respondents supported the idea of a standby tax surcharge, as proposed earlier this year by the administration to reduce the out-year deficits.

Finally concerning fiscal policy, respondents were asked, "In view of recent announcements or proposals regarding social security, defense spending, and future taxation, are you concerned now about adverse economic effects of the federal budget?" About 87 percent answered yes, and those were asked, "Do you think the main adverse effect will be on capital formation, real interest rates, or inflation?" Twenty percent answered capital formation; 29 percent, real interest rates; 12 percent, inflation; and 37 percent, all of the above.

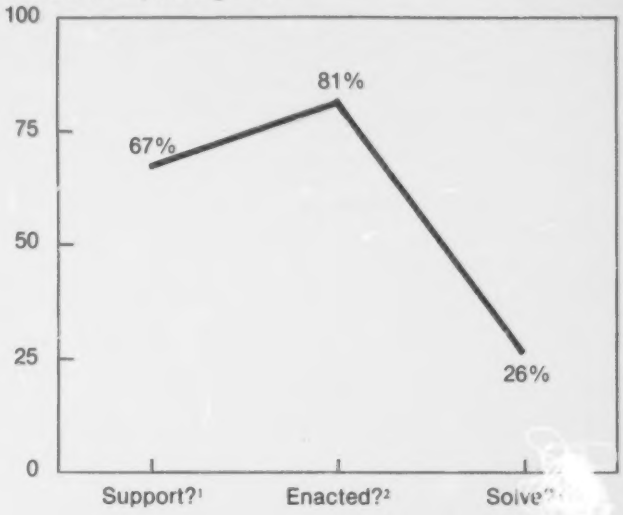
Social Security

The NABE members were queried about the agreement announced shortly before the February survey to reduce or eliminate the social security funding deficits. As Chart 2 shows, about two-thirds were generally supportive of the proposed changes, and over 80 percent (correctly) forecast that the current Congressional session would approve them, but only about a quarter believed the changes would really solve the long-run problem. This support for the social security package agreement was perhaps presaged by the business economists' responses to earlier questions on social security reported in the Winter 1983 issue, where strong majorities favored reducing the rate of increase of benefits (though the agreement makes only a one-time adjustment here) and gradually raising the eligible retirement age.

Economic Problems

The final question in the February survey asked the NABE members to rank from a list of six problems "the *three* issues you see as the most serious economic problems in 1983." The responses are displayed in Table 2. Unemployment lead the list in February, as might have been expected given the economic climate then, but budget deficits and international financial and trade problems were next in rank. Indeed, if a simple weighting scheme is used (3 for most serious, 2 for second most serious, and 1 for third most serious), those three problems are seen to be fairly close in their overall ranking. Finally, both interest rates and government credibility received some support as major problems, with only inflation not expected to prove troublesome.

CHART 2: Opinions about the Social Security Reform Package



[1]A general agreement has been reached between the administration and leaders in Congress to reduce the social security funding deficits. Are you generally supportive of the proposed changes?

[2]Do you believe the proposed changes will be enacted by Congress in the current session?

[3]Do you believe the proposed changes would solve the problem?

TABLE 2: Three Most Serious Economic Problems in 1983

Problem	Most Serious	Second Most Serious	Third Most Serious	Weighted Average Value
Inflation	3.6%	2.6%	4.7%	3.4%
Unemployment	31.8	19.4	18.7	25.5
Interest Rates	10.8	19.4	16.1	14.5
Budget Deficits	22.6	18.9	19.7	20.9
International Financial and Trade Problems	16.4	29.6	22.8	21.9
Credibility of Government Policies	14.9	10.2	18.1	13.9

Dual Economy: Nightmare or Model for the Future?[1]

Burkhard Strumpel
Director, Research Center for Work and Society
Free University of Berlin

The scene is set in a large Berlin plant of a tobacco conglomerate having its corporate headquarters outside of Berlin. The plant was established 20 years ago and produces 60-70 million cigarettes daily. There are now 800 employees; in 1977 it took 1,100 employees to produce the same volume of output. The plant houses 10 so-called "cigarette streets," each of which turns out 5,000 cigarettes per minute. To service the machines making up these "streets," 200 men and 200 women work in two shifts per day. Most of the women work as machine operators, while most of the men perform as foremen and skilled workers in emergency repair functions. The speed of the cigarette streets dictates the pace of work, and successful operation requires that the occurrence and duration of standstills be minimized.

The forwarding department of the cigarette plant offers a different kind of work and demands a different kind of worker. Heavy physical effort is required to load approximately 18 trucks per day, outdoors, rain or shine, summer and winter. Nobody has been able to remain in the department beyond the age of 50. Nevertheless, work here is more attractive than on the cigarette streets because it does not involve shift work.

In order to maintain its highly automated and capital-intensive line of production, the company prefers a certain kind of worker. What is required much more than specific skills is concentration, reliability, alertness, knowing one's way around the plant, knowing the people, team work, physical and psychic stamina, and subordination to the rhythm of the production routine. These are characteristics and modes of behavior that to a large extent must be developed and can be learned only through a longer tenure in the plant, but they are not easily transferable to other employees. They presuppose a work force committed full time and are mostly not in themselves rewarding but require extrinsic incentives for employee motivation. The level of financial rewards in the cigarette plant is reasonably high and exceeds the union-negotiated wage: 12 monthly salaries plus a 2-month bonus, pension schemes, and other fringe benefits.

This calculus seems to be reflected in the hiring practices of the plant as explicitly stated by the personnel manager:

> In deciding whether or not to hire an employee, regardless if unskilled, skilled, or foreman, we place a 51 percent weight on how much he will fit in as a person and 49 percent on how well qualified he is. We'd rather hire an average person if the impression he leaves us with, if the conversation with him shows, this is someone who fits in with us, is honest, not overwhelmed by unpaid bills.

Insiders versus Outsiders

The Berlin cigarette factory is the paradigmatic, perhaps somewhat extreme case of the transition to tomorrow's industrial reality, in the following respects:

1) Labor is vigorously replaced by capital—only 10 percent of the cost of the plant is wages.
2) It appears that a certain life style which may be prevalent particularly among young people but is expected to present obstacles to organizational socialization tends to be rejected in the process of hiring.
3) A small and shrinking work force, relatively secure, is asked to perform to the limits of their physical and psychic endurance and to muster loyalty and commitment in exchange for ample extrinsic rewards.

These "insiders" are in many respects overemployed. Many would prefer drastically reduced work hours, with given compensation per hour, particularly women and older workers. They are getting very concerned, and for apparent good reason, about stress and its effects on health. Sixty percent of the labor force in our Berlin sample approves of the item "working hard in my line of occupation goes at the expense of your health in the long run." And about 60 percent of blue collar workers entering the status of beneficiaries of old age insurance did so in 1979 without reaching the normal age of retirement (as compared with 35 percent of white collar workers). Disability statistics have risen precipitously since 1973, partly, to be sure, as a consequence of employment demands.

In short, the majority is working hard, and they know it. They have secure jobs, and they know that too. This knowledge makes them suspicious of others who do not work regularly. Resentment is growing against the unemployed; the more of them there are, the more widespread the view among the majority that the jobless themselves are responsible for their condition.[2] Separation breeds ignorance, misunderstanding, backlash.

How does it look from the other side of the fence, from the perspective of the minority of "outsiders"? Here we can distinguish two types, the "grudging conformers" and the "new entrepreneurs." The former is illustrated by the following comments from an interview with a shift worker. Responding to the question, "For how long have you held this job?", the worker answered:

> Six months, but they pay well, DM 2,500 [about $1,050] for an unskilled worker. I was forced to accept the job; otherwise they would have stopped paying unemployment compensation.

Earlier he had been enrolled for 2½ years in a commercial training program. He left when his boss asked him to wear a tie: "I found the idea appalling that I had to wear

[1]This is an edited version of an address given in June 1982 at the meeting of the board of trustees of the Aspen Institute for Humanistic Studies in Berlin, Germany. It is based in part on standardized and in-depth interviews taken for the German part of the internationally comparative study *Jobs in the 1980s*, coordinated by Daniel Yankelovich, New York, and Hans Zetterberg, Stockholm.

[2]E. Noelle-Neumann (ed.), *The Germans, Public Opinion Polls 1967-1980* (London: Greenwood Press, 1981), p. 309.

what he wishes—this is not my life style." Commenting on the choices he faced after leaving the training program, he said:

> Normally man has the possibility to provide for his food in free nature, to survive there, but here in the city you cannot do anything but deal with office bureaucrats to feed yourself. I did not even feel like doing odd jobs. But after a year the rent was unpaid and people kept coming in to collect bills, so I started working again. The best way to get rid of the pressure is to go to work each morning—force yourself, do what you are told to do, don't talk back. There is nothing in my job besides going there on time, checking out on time.

Interviews were also taken with the "new entrepreneurs." Together with three other young people, one founded a photo gallery. He explains his motivation:

> I am a university graduate, electrical engineering. When I got my degree, I became unemployed. The time I was unemployed I spent thinking about what I really wanted to do. After I was offered a job as an electrical engineer with Siemens, I suddenly happened to open the photo shop, quite spontaneously, more as a makeshift solution to escape the job with Siemens.

About his present work, he notes:

> What I like about it is that I am more or less able to do what I want to do. I can choose my working time, I can take the photographs I like to take, I do not depend on magazines or on sport pictures alone. The only disadvantage is that financially the picture is not always rosy.

A Vicious Cycle of Social Disintegration

The increased unemployment of recent vintage makes visible the contours of the economy and society we will get if present trends continue. People inside will be financially well compensated, on secure jobs, disciplined and strained, risking their health. They will be exposed to involuntary technological changes in the nature of their jobs, some changes for the better, others for the worse, and all of them threatening if occurring in short sequence as they typically do. Life outside is characterized by frustration, unused skills, odd jobs, often the recourse to welfare, with only a few able to cope constructively.

Both sides are contributing to a vicious cycle of social disintegration. Those inside fail to share opportunities and insist on their rules of the game and are suspicious of outsiders, while outsiders can maintain a semblance of self respect only through blaming "the system." Society becomes a training ground for polarization and resentment. Some observers see a nation or a hemisphere split not by class lines but by employment status: full employment versus marginalization, a society involved in heavy distributional conflict revolving around opportunities more than money. Welfare *and* warfare; a welfare state but a police state as well.

How do we step beyond diagnosis? The threat of the dual economy as a nightmare seems to be recognized. Yet it is defined differently by different groups. By many it is defined not as a common problem, inherent in the present juncture of the history of industrial countries, but rather as a condition caused by whoever is on the other side of the fence. Instead of a variable sum game where the total payoff can be increased by joint effort, the condition tends to be defined as a zero sum game, as a distributional problem.

As things stand now, nobody wins. The insiders and outsiders obstruct each other in many ways. Absenteeism and low productivity growth in part may be considered a last resort defense against being trapped in the realm of monetarized centralized production. If the economy fails in its human tasks, unemployment becomes for many an inescapable predicament; and for some it may even turn into a matter of entitlement. The industrial system, on the other hand, by holding much too firm a grip on the remaining faithful, and by selective hiring practices, seems to have given up hope of recapturing the loyalty of the heretics.

In search of a positive sum game: where is the solution that makes us all better off? The conventional positive sum game is more growth and more productivity. Lagging productivity may be an important problem inside, and attacking it is important. Yet productivity growth will not solve the problem outside and certainly will not lead to a turnaround of the unemployment situation. Technological progress eliminates jobs, but it is true as well that technological stagnation fails to defend jobs against inevitable structural change. We are damned if we do and damned if we don't.

I believe that a strategy for productivity growth through technological progress and increased work commitment is important and must be undertaken. Yet it will fail if not accompanied by a drastic reduction and "flexabilization" of working time. But it will become increasingly difficult to compensate for job stress and the threat to health by monetary incentives or to design full-time jobs for lower echelons that manage to eliminate those threats. Stress and threats to health are both intimately related to working time. Reductions in working time, both across the board and through flexible hours, would also create pressure for the formal sector to hire potential workers from outside who at first sight seem difficult to socialize.

A Symbiosis between the Formal and Informal Economies?

Any attempt merely to take care of the problems inside and to forget about the problems outside is doomed to failure. The private industrial sector cannot solve several problems at once: fully employing the labor force, supporting growing numbers of nonworkers, paying tax rates which enable government to subsidize ailing industries, and still staying viable itself.

There are two postwar social contracts of the Keynesian type that were enormously successful at the time but fail to work now. First, the contract between people and private industry: hard work in exchange for hard goods and full employment. Second, the contract between people and government: social peace based on the sense of equity in exchange for the welfare state.

The first contract no longer delivers full employment and the satisfaction resulting earlier from the provision of hard goods; consequently, it fails to elicit hard work. The second contract fails to be supported by prevailing notions of equity as suggested both by the despair of those who are reasonably fed and clothed but unemployed or underemployed, and by the rising backlash of the still-comfortable majority.

The problem has to do with what Polanyi 40 years ago called the Great Transformation: The formal, monetarized market sector has come to monopolize the provision of

material well being, social status, and individual integrity or self-esteem. But it is high time we recognize that the formal sector in our day and age will be incapable of solving the task of providing economic and social integration for all people of working age. Alternative chances have to be opened up, and this points to the importance of the informal sector.

The informal sector will have to tie unutilized human resources to needs for services and goods not satisfied by the formal economy. Its characteristics are a lower productivity as compared with the monetarized market economy, a relatively high "meaning" of the products or the work it provides, relatively high autonomy of work, and decentralization of production. It is to be geared to a particular life style of post-materialism (Inglehart[3]) or self-fulfillment (Yankelovich) characteristic of a substantial and growing segment of society.

Who is going to populate the informal sector? Will it be integrated in the sense that the same people alternate between both sectors, thus engaging in job sharing on a grand scale? Or will it be segregated, with each of the economies closing the gates, tightly regulating access from the other side—a state of affairs perhaps reminiscent of medieval estates?

For the goal of social peace, the idea of most people "commuting between apparatus and networks" (Hans Zetterberg) would have its attractions: everybody would have a part-time job in the formal, and another part-time job in the informal economy. While I believe we must go in this direction—and the signs are on the wall if we observe for instance the flood of women into the labor market and the increasing involvement of men in household work or do-it-yourself activities—rushing toward this solution would misinterpret the indicators of cultural change evident from our and other data. A single economy will not accomodate both life styles—one of hard, disciplined work in the formal economy, with higher claims on the perquisites of that commitment, and a different one of economic disarmament.

We must offer choice, in the spirit of both democratic pluralism and socially responsible capitalism and unionism. Yet the new social contract that is needed must respect prevailing notions of distributive justice. Equity is the critical point. First, people tolerate alternative life styles but do not want to see able-bodied compatriots loaf at their expense. Second, the informal sector cannot be granted material parity with respect to the consumption of goods and services produced by the formal sector, including income guarantees.

The establishment of a viable informal sector cannot be brought about by the traditional techniques of social and economic policy. These strategies have always relied primarily on centralized intervention, monetary incentives, global variations of prices, tax rates, public subsidies. Establishing a viable informal sector means institution building and innovative organizing. In this and other respects, a new social contract leading to a benign dual economy places high demands on societies' creativity, tolerance, and solidarity, a challenge comparable only with the evolution of the welfare state generations ago.

[3]For a brief discussion of post-materialist values, see Ronald Inglehart, "Value Change Among Western Publics," ECONOMIC OUTLOOK USA, 4:4 (Autumn 1977), p. 60-63.

Actual and Projected Economic Indicators

seasonally adjusted

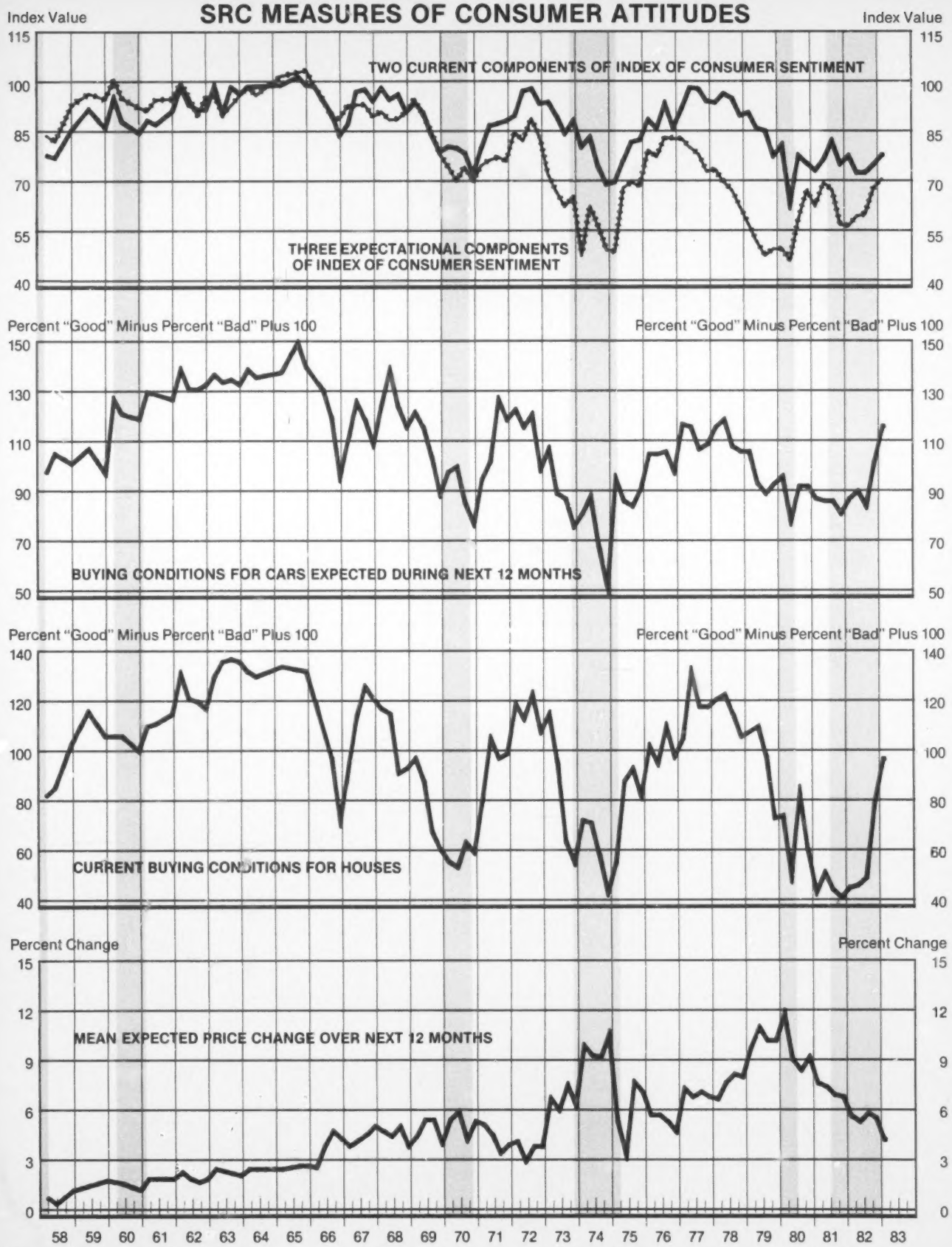
SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Act'l.	Projected	
	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1983:1	1983:2	1983:3	1983:4	1984:1	1982	1983	1984
GROSS NATIONAL PRODUCT	2,981	3,003	2,996	3,045	3,088	3,108	3,177	3,160	3,225	3,297	3,379	3,460	3,059	3,265	3,578
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	197.4	201.6	203.7	206.0	208.5	210.4	213.4	212.9	215.3	218.0	221.0	223.5	207.1	216.7	228.1
CORPORATE PROFITS AFTER TAXES	150.8	144.9	115.0	116.3	119.4	117.9	NA	122.0	127.2	135.0	142.0	145.7	117.2	131.0	156.4
UNEMPLOYMENT RATE (percent)	7.400	8.300	8.800	9.400	9.967	10.67	10.37	10.50	10.30	10.10	10.00	9.800	9.708	10.20	9.400
INDUSTRIAL PRODUCTION (index, 1967 = 100)	153.0	146.3	141.8	139.4	138.2	135.3	138.0	137.0	139.6	142.0	145.3	148.0	138.6	141.0	152.0
NEW PRIVATE HOUSING UNITS STARTED (millions)	0.961	0.870	0.903	0.950	1.122	1.261	1.693	1.350	1.450	1.500	1.540	1.600	1.059	1.470	1.645
CONSUMER PRICE INDEX (% change from prior quarter or year)	12.0	7.2	3.0	5.3	7.8	2.0	-0.4	2.9	4.1	4.3	4.6	5.0	6.2	4.1	5.2
90-DAY TREASURY BILL RATE (%)	15.09	12.02	12.90	12.36	9.71	7.94	8.08	7.88	7.50	7.65	7.95	8.00	10.72	7.80	8.00
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	16.33	16.01	16.14	15.65	14.72	12.22	NA	11.65	11.50	11.40	11.30	11.50	14.68	11.50	11.20
GNP IN 1972 DOLLARS	1,510	1,490	1,471	1,478	1,481	1,477	1,489	1,485	1,495	1,510	1,527	1,541	1,477	1,503	1,565
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	951.4	943.4	949.1	955.0	956.3	967.0	972.4	974.0	980.5	990.0	998.0	1,007	956.8	985.2	1,019
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	173.9	174.2	172.0	166.7	163.4	160.9	162.0	156.0	154.6	154.3	156.0	159.9	165.8	155.0	163.0
RESIDENTIAL FIXED INVESTMENT (1972 $)	42.9	39.9	38.9	40.1	39.5	42.9	49.9	44.0	47.0	49.6	51.8	53.3	40.4	48.1	55.7
CHANGE IN BUSINESS INVENTORIES (1972 $)	16.5	4.8	-15.4	-4.4	3.4	-20.3	-12.4	-5.0	0.9	2.9	5.0	7.0	-9.2	0.5	9.0
NET EXPORTS (1972 $)	39.2	36.5	36.9	35.7	27.5	27.2	24.0	20.0	18.8	18.5	19.4	19.1	31.8	19.0	20.0
FEDERAL GOVERNMENT PURCHASES (1972 $)	110.7	116.0	114.4	110.3	116.2	124.7	117.5	121.0	120.0	122.0	124.0	124.8	116.4	122.0	126.0
STATE & LOCAL GOVERNMENT PURCHASES (1972 $)	175.7	175.3	174.9	175.0	174.9	174.8	175.1	175.0	175.0	175.0	175.0	175.0	174.9	175.0	176.0

SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1980:2	1980:3	1980:4	1981:1	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1980	1981	1982
GROSS NATIONAL PRODUCT	2,573	2,644	2,739	2,865	2,902	2,981	3,003	2,996	3,045	3,088	3,108	3,177	2,633	2,938	3,059
PERSONAL CONSUMPTION EXPENDITURES	1,622	1,682	1,746	1,800	1,819	1,869	1,885	1,919	1,948	1,986	2,031	2,054	1,667	1,843	1,971
GROSS PRIVATE DOMESTIC INVESTMENT	391.0	384.1	410.3	455.7	475.5	486.0	468.9	414.8	431.5	443.3	391.5	430.6	402.3	471.5	420.3
NET EXPORTS	24.2	39.0	23.5	31.2	23.7	25.9	23.5	31.3	34.9	6.9	9.1	16.6	25.2	26.1	20.6
GOVERNMENT PURCHASES	536.0	538.5	559.8	578.1	583.2	600.2	626.3	630.1	630.9	651.7	676.8	675.5	538.4	597.0	647.4
DISPOSABLE PERSONAL INCOME	1,781	1,846	1,903	1,959	1,997	2,060	2,101	2,117	2,152	2,198	2,224	2,247	1,824	2,029	2,173
PERSONAL SAVING RATE (% of disposable income)	6.1	6.1	5.5	5.4	6.1	6.5	7.5	6.6	6.7	6.9	6.0	5.9	5.8	6.4	6.5

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late April, and projected data, released by ASA-NBER in March, are displayed for first quarter 1983.

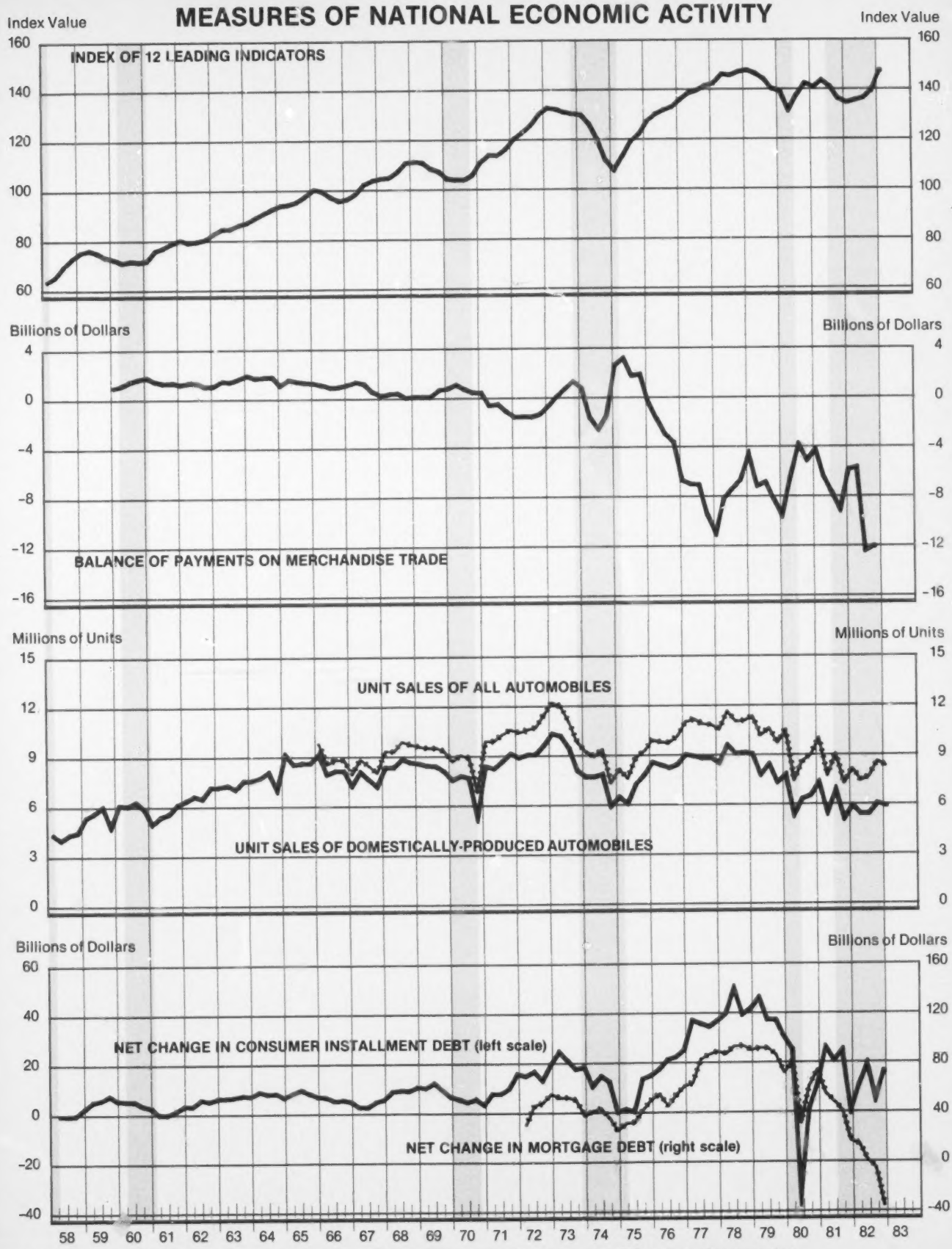
Sources: Projections: American Statistical Association–National Bureau of Economic Research panel of forecasters.
Actual Date: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

SRC MEASURES OF CONSUMER ATTITUDES



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



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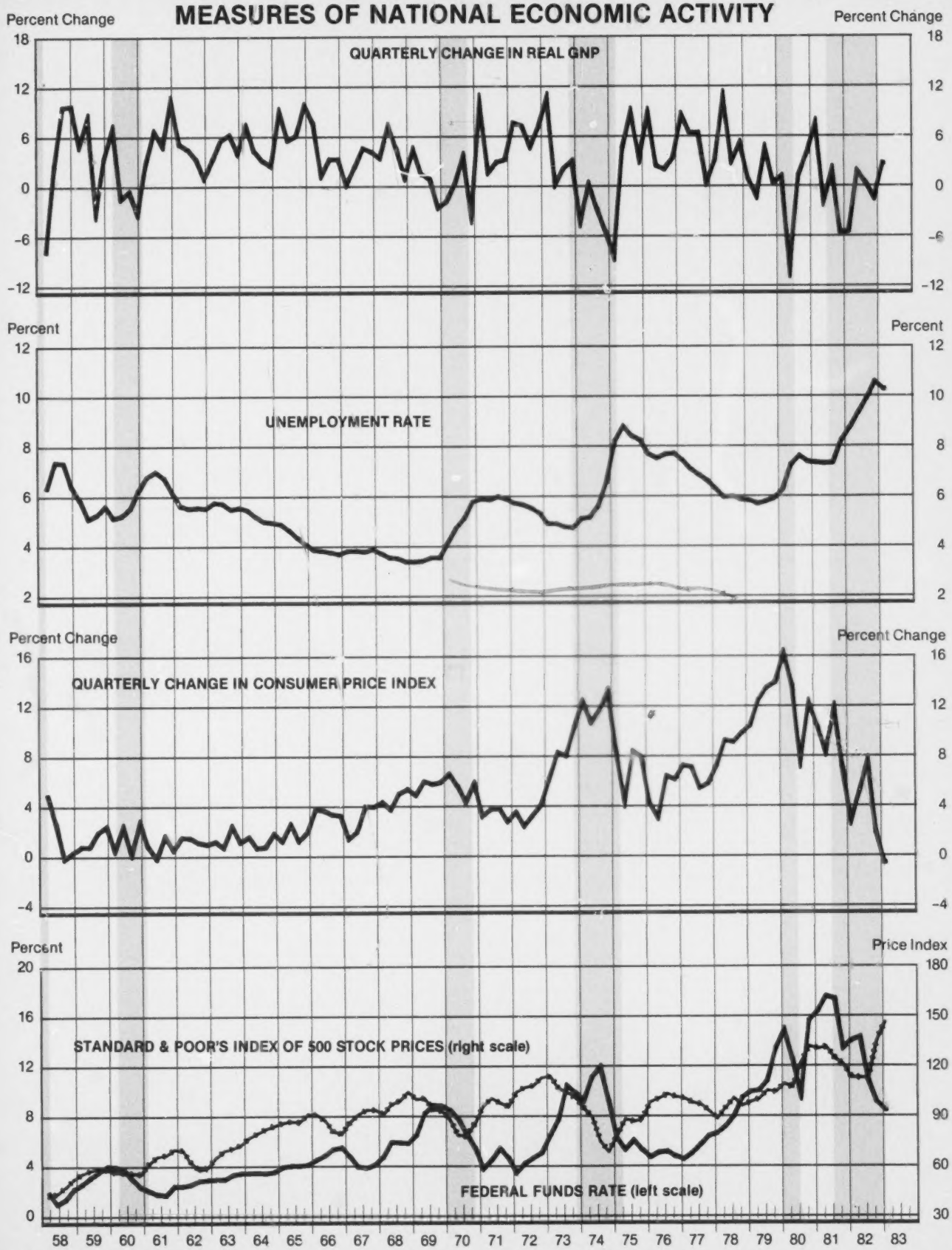
MEASURES OF NATIONAL ECONOMIC ACTIVITY



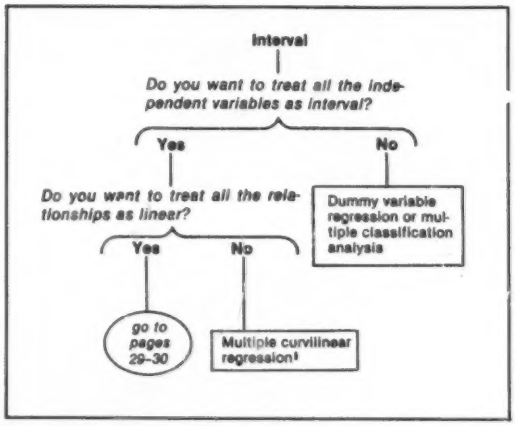
Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

Revised and Expanded

A Guide for Selecting Statistical Techniques for Analyzing Social Science Data

Second Edition

by Frank M. Andrews,
Laura Klem, Terrence N. Davidson,
Patrick M. O'Malley, and Willard L. Rodgers


Interval
Do you want to treat all the independent variables as interval?
Yes
No
Do you want to treat all the relationships as linear?
Dummy variable regression or multiple classification analysis
Yes
No
go to pages 29–30
Multiple curvilinear regression¹

In its popular first edition, this handbook became a valuable reference tool for social scientists and data analysts in fields as diverse as psychology, sociology, economics, political science, education, public health, marketing, evaluation research, and statistics.

The substantially enlarged second edition retains most of the original material from the first edition, and adds significant new material that includes greatly expanded coverage of multivariate analysis. It presents a systematic, condensed overview of nearly 150 currently used statistics and statistical techniques and their applications.

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For each statistic presented in the Guide a major reference is cited in Appendix A, including the specific pages on which the statistic is discussed and its means of computation given. Appendix B, which indicates where each statistic can be found in the output from computer software, has been expanded to include detailed information on sources in the OSIRIS, MIDAS, SPSS, SAS, and BMDP software systems.

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Hymans and Crary
Midyear Review and Forecast:
The U.S. Economic Outlook for 1983-84
Richard E. Barfield
Results from the May NABE Survey
Hill and Ponza
Poverty and Welfare Dependence Across Generations
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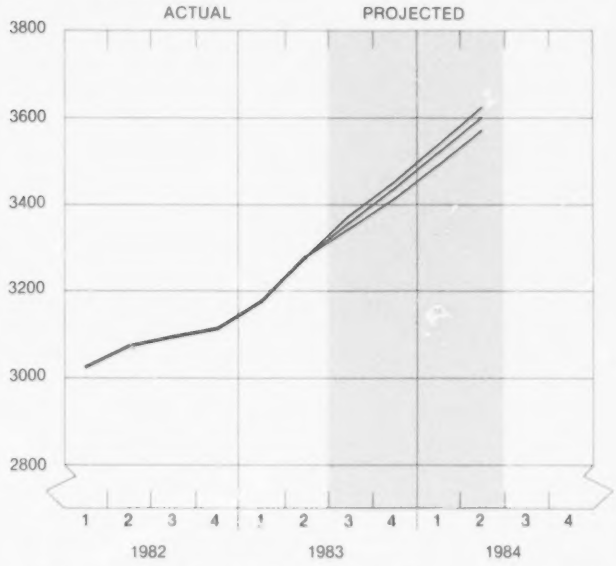
ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

GROSS NATIONAL PRODUCT

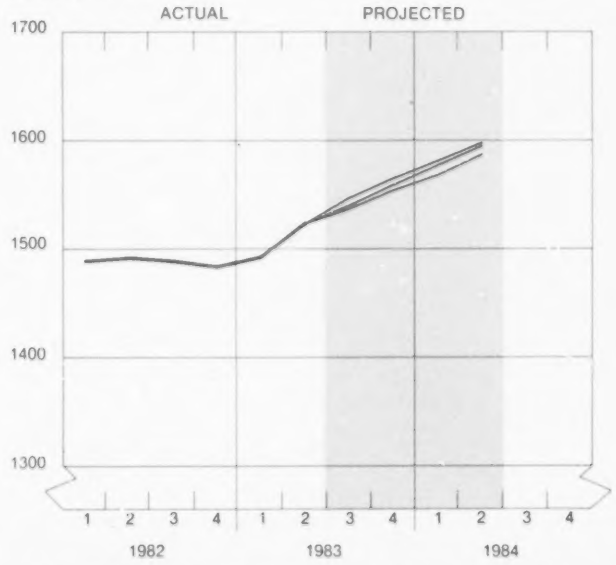
IN CURRENT DOLLARS
Billions of Dollars



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Consumer Optimism Reaches Decade Peak

Richard T. Curtin
Director, Surveys of Consumer Attitudes
Survey Research Center
The University of Michigan

Widespread Optimism

In the second quarter 1983 survey, the Index of Consumer Sentiment was 91.5, up 16.2 Index-points from one quarter earlier, and 25.3 Index-points above the year-earlier reading. In total, the Index has gained 37.1 points since the all-time record low of 54.4 was recorded three years earlier in the second quarter 1980 survey. The rapid improvement recorded since the start of 1983 has brought the Index of Consumer Sentiment to its highest quarterly reading since the 1972 peak of 94.4.

Among families with incomes of $20,000 and more, the Index of Consumer Sentiment rose to 99.3, up 17.1 Index-points from one quarter earlier and 27.4 Index-points from one year earlier. Increases of 20 Index-points or more were recorded during the past vear by residents of each major geographic region as well as across all age subgroups.

The most favorable aspects of consumer sentiment reflect the expected direction of change in the economy, not the expected level of economic performance. The record number of consumers that expected improvement also reflects the length and depth of the past recession. Thus, while consumer optimism is near record levels, there is no evidence to suggest a consumer "boom psychology." The majority of consumers now expect good times financially in the economy during the next year or so, but the majority do not expect these good times to persist uninterrupted into the longer term. Among all families in the second quarter 1983 survey, 61 percent expected good times in the economy as a whole in the next year, substantially above the 42 percent recorded in the first quarter of 1983. Longer-term business expectations also improved but remain much less favorable than short-term expectations: 39 percent of all families expected good times in the economy during the next five years in the second quarter survey, up from 30 percent in the first quarter.

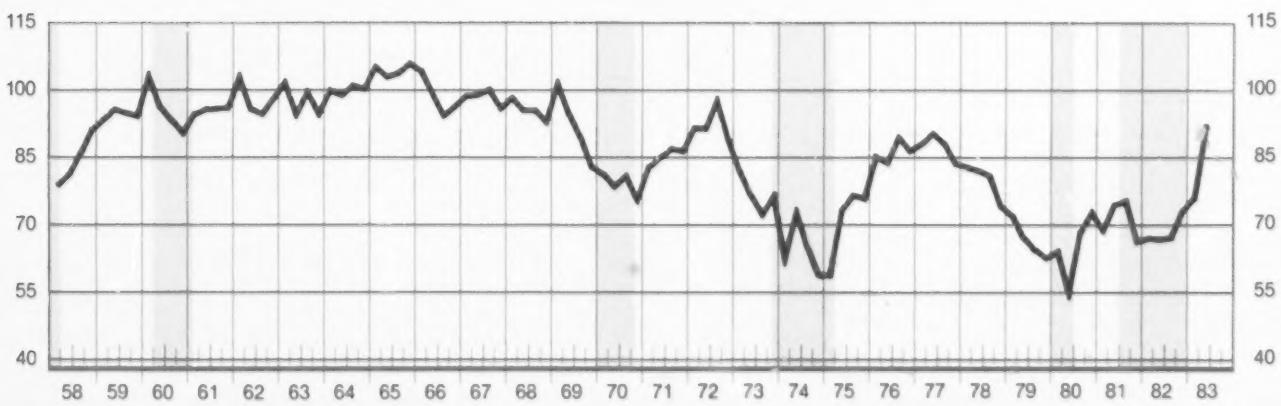
Record Awareness of Improved Business Conditions

Favorable developments in economic conditions dominated the news heard and recalled by consumers in the second quarter 1983 survey. More than twice as many favorable as unfavorable developments were reported (80 versus 31 percent), nearly the reverse of the negative balance recorded one year earlier (23 versus 88 percent). The 1983:2 survey established a new record level of favorable perceptions of recent economic developments. The improvement recorded during the past year has been due to favorable changes in employment and unemployment trends. Among all families, 29 percent mentioned instances of increased employment, up from 17 percent in the first quarter and just 5 percent one year earlier. In contrast, references to increases in unemployment fell to 19 percent in the second quarter, from 35 percent in the first quarter and 43 percent one year earlier. Fifty-nine percent of all families reported that overall business conditions had improved during the past year, substantially above the 27 percent recorded in the first quarter and just 11 percent recorded one year earlier.

Consumers remained very optimistic about the outlook for the economy during the year ahead. Among all families in the second quarter 1983 survey, 52 percent expected business conditions to improve, a new all-time quarterly record. Only 7 percent of respondents expected business conditions to worsen during the year ahead. The expected decline in unemployment has been the dominant factor associated with the recent improvement. Unemployment was expected to decline by 40 percent of all respondents in the 1983:2 survey, up from 29 percent in the first quarter and 16 percent one year earlier. The proportion of respondents that expected increases in unemployment during the year ahead was just 15 percent in the second quarter 1983

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

survey, down from 27 percent in the first quarter and 48 percent one year earlier.

Personal Finances Improve

For the first time during the past five years, families in the second quarter 1983 survey more frequently reported that their financial situation had improved rather than worsened during the past year (37 versus 31 percent). Among families with incomes of $20,000 and over, nearly twice as many families reported improvement rather than deterioration in their personal finances (47 versus 24 percent). The recent improvement has been due to more frequent reports of income increases (30 percent in the 1983:2 survey, up from 27 percent in both the one-quarter and one-year-earlier readings), while reports of income declines were less frequent (19 percent in the second quarter, down from 24 percent in the first quarter but equal to the 19 percent recorded one year earlier.) In addition to the improvements in family income, the fewest consumers in more than a decade mentioned the adverse impact of inflation on their family budgets in the recent survey (18 percent).

Consumers also remained very optimistic about the outlook for their personal financial situation during the year ahead: five times as many families expected an improving rather than a worsening financial situation (40 versus 8 percent). Compared with a year earlier, in the second quarter 1983 survey fewer families expected their incomes to decline (12 down from 17 percent), more families expected their incomes to remain unchanged (26 up from 23 percent), and more families expected income increases of 1 to 5% (20 up from 16 percent). The proportion of families that expected income increases of 6% or more remained unchanged from a year earlier at 37 percent.

The rate of inflation expected by consumers during the year ahead was 4.6% in the second quarter 1983 survey, somewhat above the 4.3% recorded in the first quarter but below the 5.4% recorded one year earlier. The modest improvement in income expectations coupled with lower price expectations resulted in the most favorable real income expectations recorded during the past decade. In the 1983:2 survey, two-thirds of all respondents expected their family incomes to keep pace with or exceed the rate of inflation.

The 1983 Tax Cut

In the June 1983 survey, respondents were asked whether they expected their monthly take-home income to change as a result of the federal tax legislation, repeating questions asked in earlier surveys (see Table 1). Fewer respondents reported that they expected their incomes to increase in the 1983 survey (22 percent) than in 1982 (28 percent) or in 1981 (46 percent). Among those families that expected increases in their take-home pay, the median monthly expected increase was $25 in 1983, unchanged from the 1982 figure and just half the amount expected in 1981.

When asked whether they planned to save or spend the increase in after-tax income, families reported plans for spending more frequently in June 1983 (46 percent) than in 1982 (43 percent) or in 1981 (25 percent). In contrast to 1982, when almost the entire increase in spending plans was related to meeting current needs and expenses, the increase in spending plans recorded in 1983 was more likely to be for major new purchases, such as household durables, vehicles, and home additions and repairs. Nonetheless, two-thirds of all spending plans remained relegated to meeting current needs and expenses. Compared with a year earlier, respondents somewhat more frequently expected to save the additional after-tax income (28 up from 25 percent), while somewhat fewer respondents reported that they expected to use the added income to repay debt (19 down from 23 percent).

TABLE 1. Expected Change in Monthly Take-Home Pay Resulting from Personal Income Tax Reductions

Expectations and Plans	1981	1982	1983
Expect Take-Home Pay to...			
Increase	46%	28%	22%
Stay the same	40	55	57
Decrease	2	5	6
Doesn't pay taxes	6	7	11
Don't know	2	2	3
Not ascertained	4	3	1
	100%	100%	100%
Expected Increase in Monthly Take-Home Pay			
Median amount	$50	$24	$25
Planned Use of Increase in Take-Home Pay			
Spend	25%	43%	46%
(on new purchases)	(8)	(8)	(15)
(on current expenses)	(17)	(35)	(31)
Repay debt	21	23	19
Save, invest	41	25	28
Both spend and save	4	4	6
Don't know; not ascertained	9	5	1
	100%	100%	100%

The questions asked were: (April-May 1981) "If the personal income tax reductions were actually passed, would you expect your monthly take-home pay to increase, stay the same, or what? (If 'increase') About how much more money would you expect to take home each month? What do you think you would do with this money—spend it, save it, invest it, repay debts, use it for a down payment on something, or what?" (July-Oct. 1982, June 1983) "As a result of the (1982/1983) federal tax cut, would you expect your monthly take-home pay to increase, stay the same, or what?" [Remainder of question same as in 1981.]

Favorable Buying Attitudes

Attitudes toward market conditions for the purchase of cars and houses reached record favorable levels in the second quarter 1983 survey. Nearly two-thirds of all American families thought buying conditions were favorable for purchases of houses, cars and large household durables. The substantial improvement in buying attitudes has been due to the combination of two factors which have not previously dominated recoveries in consumer buying attitudes: lower prices and lower interest rates.

In the 1983:2 survey, 64 percent of all American families rated buying conditions for houses favorably, the highest proportion ever recorded (see Table 2). The pace as well as the extent of improvement recorded during the past year

TABLE 2. Attitudes toward Housing and Automobile Markets

	Houses		Cars	
	1977:2	1983:2	1978:2	1983:2
Proportion Holding Favorable Attitudes	63%	64%	52%	65%
Selected Reasons:				
Low prices	4	23	7	26
High prices	22	13	23	19
Net	−18	+10	−16	+7
Low interest	12	57	1	40
High interest	10	23	3	8
Net	+2	+34	−2	+32
Buy-in-advance	47	7	36	10

has set new records. The proportion of families giving favorable evaluations of buying conditions for houses rose from just 21 percent in the third quarter of 1982 to the record high of 64 percent in the second quarter of 1983. The major reasons given by consumers for this abrupt turnaround in house-buying attitudes have been lower mortgage rates and lower housing prices. During the past year, complaints of high mortgage rates fell from 74 to 23 percent, while references to the availability of lower mortgage rates rose from 6 to 57 percent. Mentions of the availability of lower housing prices rose to 23 percent in the second quarter survey from 15 percent one year earlier, while references to high housing prices fell to 13 from 26 percent.

The proportion of American families holding favorable attitudes toward buying conditions for cars was 65 percent in the second quarter 1983 survey, a new all-time record quarterly reading (Table 2). The primary reason for favorable car-buying attitudes has been the availability of lower interest rates, mentioned by 40 percent of all respondents, while complaints of high interest rates fell to just 8 percent in the second quarter of 1983. Compared with a year earlier, mentions of lower prices and rebates fell from 35 to 26 percent, but references to high car prices also fell by a similar amount, from 29 to 19 percent, maintaining the favorable balance of opinion.

Interest Rate Sensitivity

The last cyclical peak in favorable attitudes toward buying conditions for houses was recorded in the second quarter of 1977, when 63 percent of all families rated house-buying conditions favorably. At that time, the major reason given for favorable house-buying attitudes involved buy-in-advance price rationales, reported by 47 percent of all families. In sharp contrast, in the second quarter 1983 survey just 7 percent of all families mentioned buy-in-advance price rationales. In 1977 more families referred to high rather than low housing prices, while at the 1983 peak low rather than high prices were more frequently mentioned. As shown in Table 2, just as favorable buying attitudes in 1977 and 1978 were dominated by buy-in-advance price rationales, favorable house- and car-buying attitudes in 1983 have been dominated by the appeal of lower interest rates.

Declines in interest rates have already reduced the backlog of postponed purchases to a substantial extent. In the second quarter 1983 survey, 20 percent of all families reported that they had postponed purchases due to high interest rates, substantially below the 33 percent recorded six months earlier (see Table 3). The median interest rate that would have been charged on the postponed purchase was 16.3% in the second quarter, unchanged from the first quarter reading and one percentage point below the 1982 levels. While the highest interest rate consumers were willing to pay was approximately 11% for vehicles, houses, and household durables, the interest rate reported that would have been charged on these purchases was nearly 2 percentage points higher for household durables than for vehicles and houses. Consequently, credit purchases of household durables were most likely to be resisted, largely because of the lack of declines in interest rates charged on credit cards.

In the second quarter 1983 survey, fewer families expected continued declines in interest rates, and more families expected that interest rates would remain unchanged at their current levels during the year ahead. Among all families, 31 percent expected declines in interest rates, down from 42 percent in the first quarter of 1983 and a cyclical high of 46 percent in the fourth quarter of 1982. The proportion of families that expected increases in

TABLE 3. Interest Rate Effect on Consumer Purchases, 1982:1-1983:2 (Entries are Percentages)

	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2			
	All Items	All Items	All Items	All Items	All Items	All Items	Vehicles	Housing	Household Durables
Proportion Postponing Purchase	33	32	34	33	26	20	8	6	6
Interest Rate that Would Have Been Charged on Postponed Purchase*	17.7	17.5	17.6	17.4	16.2	16.3	15.2	15.4	17.0
Highest Interest Willing to Pay to Make Purchase*	12.0	11.9	11.9	11.7	10.9	11.0	10.8	11.2	11.1
Difference between Interest Rate Charged and that Willing to Pay*	5.1	5.1	5.3	5.2	4.5	4.3	3.8	4.1	5.1

*Median values for families who postponed a purchase.

The questions asked were "Have interest rates caused you to postpone making any purchases during the last six months? What was postponed? What interest rate would have been charged on any money borrowed for (item)? What is the highest interest rate at which you would have purchased (item)?"

interest rates remained largely unchanged from the prior two quarters (23 percent, compared with 20 and 22 percent), while the proportion that expected interest rates to remain at the same level during the year ahead rose to 44 percent in 1983:2, up from 35 percent in the first quarter and 28 percent at the close of 1982.

The heightened dependence of buying attitudes on interest rates will continue to shape subsequent developments in buying attitudes. Further declines in interest rates will continue to support favorable buying attitudes, while increases in interest rates are likely to cause serious and immediate reversals in favorable buying attitudes. Even if interest rates were to stabilize at current levels, their favorable impact on buying attitudes would gradually recede over time as people became accustomed to the prevailing rates.

Summary Outlook

A robust recovery in sales of vehicles, houses, and large household durables through early 1984 will benefit from very favorable consumer attitudes and expectations. The rapid improvement recorded since the start of 1983 has been widespread across all aspects of consumer sentiment as well as across all major population subgroups. The personal financial situation of American families has improved substantially during the past several months due to more favorable income and price trends. Declines in prices and interest rates have stimulated very favorable attitudes toward buying conditions for vehicles and houses. The pace and length of the recovery will depend not on further changes in the *willingness* of consumers to make large discretionary purchases, but rather on the *ability* of consumers to finance significant increases in their purchases of vehicles and houses without a resurgence in interest rates.

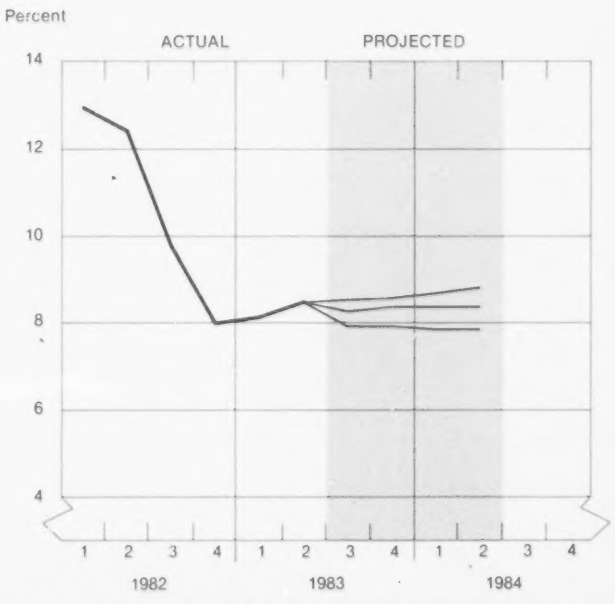
The second quarter 1983 survey marked the completion of the third year since the all-time record low of 54.4 was recorded in the Index of Consumer Sentiment. The 1980 low was record-setting due to a combination of unfavorable developments: the majority of consumers expected double-digit inflation, two-thirds expected increases in unemployment, and high interest rates led the the majority to view buying conditions unfavorably. Inflation expectations have declined steadily since then, and by a substantial amount. The cumulative declines in inflation expectations have had a persistent and significant impact on consumers' expectations for both their personal financial situation and the economy as a whole, partially softening the adverse impact from the renewed economic downturn starting in mid-1981.

In contrast to the uninterrupted three-year decline in inflation expectations, unemployment expectations improved following the 1980 low point, but the improvement was quickly reversed in 1981. Unemployment expectations again improved starting in the last half of 1982 and have been the primary factor underlying the rapid rise in consumer optimism in the first half of 1983. This pattern of change in consumer attitudes and expectations is typical of past recovery periods, which usually benefit from declines in inflation before declines in unemployment.

The distinctive aspect of this recovery is that expected trends in inflation coupled with more volatile interest-rate expectations have begun to restructure consumer attitudes toward market buying conditions. During the 1970s, consumers found the most important source of variability in buying conditions to be changes in product prices, and they frequently adopted buy-in-advance rationales in response to expected price increases. This response predominated at that time because interest rates charged on consumer loans were largely unresponsive to changes in the expected rate of inflation. The "buy-in-advance psychology" which developed represented a significant restructuring of buying attitudes from the 1950s and early 1960s. Since 1980, consumers have viewed interest rates charged on consumer loans, rather than inflation, to be the most important source of expected variability in market buying conditions. Such an "interest-rate psychology" has begun to restructure buying attitudes again and acts to focus the timing of purchase decisions on current and expected trends in interest rates.

August 1983

90-DAY TREASURY BILL RATE



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Midyear Review and Forecast: The U.S. Economic Outlook for 1983-84

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Some Observations on the Current State of the Economy

Few if any economic forecasters had anticipated that real GNP would grow at the 8.7 percent annual rate provisionally estimated for 1983:2. In our most recent monthly updates we had been forecasting growth in the range of 5½-5¾ percent for the second quarter. Consumer spending accelerated a good deal more sharply than we and most others had expected and accounts for much of the unanticipated portion of GNP growth in the second quarter. We are now forecasting that real GNP will increase by about $27 billion (1972 dollars) in 1983:3, which implies an annualized growth rate of 7.3 percent. We are forecasting a $14 billion (1972 dollars) increase in consumer purchases in the current quarter, compared with nearly $24 billion in 1983:2. Nearly two-thirds of the slowdown appears in the consumer durables category largely as a result of automobile sales, which are forecast to rise by about 600 thousand units (annual rate) in the current quarter compared with nearly a 900 thousand unit increase in the preceding quarter. Real expenditures on residential construction are forecast to be up by $4.2 billion this quarter as compared with $5.7 billion in 1983:2, and the rate of inventory accumulation is forecast to be up by $9.4 billion in the third quarter compared with $10.9 billion in the second quarter. In combination, the categories of consumption, residential construction, and inventory investment are forecast to account for a $12½ billion reduction in GNP growth between the second and third quarters of this year. About $8 billion of this reduction is forecast to be offset by faster growth of real government purchases and business capital purchases and a continued but slower rate of deterioration in net exports. On balance, therefore, real GNP is forecast to be up by $27 billion in the current quarter, or $4 billion less than in the previous quarter. Back-to-back quarterly GNP increases of $31 and $27 billion will have a major impact on the unemployment rate in the current quarter. We are expecting the third quarter unemployment rate to be 9/10 of a percentage point below that of the second quarter and thus to average about 9.3 percent for the quarter as a whole.

Actual and expected trends in interest rates and the monetary base tell an important story. The 3-month treasury bill rate rose by 30 basis points in the second qurater, and we are forecasting an 80 basis-point rise for the current quarter to an average of 9¼ percent for the July-August-September period. With an average treasury bill rate of 7.9 percent in the last quarter of 1982, this implies an increase of more than 130 basis points in short-term interest rates during the first three quarters of the economic recovery and is, by historical standards, an unusually large increase this early in the expansion. It appears to be calculated Federal Reserve policy to nudge rates upward—apparently for two related reasons. The first is to be absolutely convincing in its resolve to keep the recovery from proceeding at a rate which might ultimately become inflationary, and the second—in our judgment—is to keep pressure on the Congress as it deals with administration budget proposals. The money markets still fear the consequences of large federal deficits and, in that context, the Fed appears to be signaling its continued willingness to counteract expansionary budgets with tight money. Compared with the late recession and early expansion periods, the Fed appears to be cutting back on its provision of reserves to the banking system—both via open market operations and its attitude at the discount window. This perception is reflected in our assumption of only a 3½ percent rate of growth in the monetary base for the current quarter, the rise in interest rates in the current quarter, and the concurrently slower growth of both the automobile and housing markets.

We turn now to a fuller discussion of policy and other inputs to the forecast.

Inputs to the Forecast

The federal tax program embodied in our forecast is the net result of the Economic Recovery Tax Act of 1981 (ERTA), the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), and the revisions to the Social Security System enacted in 1983. We have assumed that the third phase of the ERTA personal tax cut has been handled in the same way as last year's tax cut and is therefore not fully reflected in the new withholding tables for higher income brackets. As a result we are estimating that the 10 percent personal tax cut which became effective on the first of July was worth about $24 billion (annual rate) in the current quarter.

We have also assumed that there will be no withholding of interest and dividend income and that indexing of personal tax rates will begin on schedule January 1, 1985.

On the expenditure side of the budget we have assumed that the 14½ percent increase in defense expenditures for fiscal year 1983 will be followed by a 10 percent increase in FY '84 and an 8 percent increase in FY '85. These figures imply real increases in defense spending of about 5 percent and 2½ percent for FY '84 and FY '85, respectively.

Recent government actions have altered the timing of some nondefense expenditures. Social Security cost of living increases which have been paid every July in recent years have been permanently shifted to January with no cost of living increases having been made this July. In addition the pay increase for both nondefense and defense employees which usually occurs in October has been delayed to January for fiscal 1984.

In total, federal expenditures are projected to rise by 4.9 percent in fiscal 1984 and 7.3 percent in fiscal 1985 following increases of 10.9 percent and 10.2 percent for fiscal 1982 and 1983, respectively.

The net result of our budget assumptions and our forecast is a federal deficit which declines steadily in the quar-

ters following the tax cut through fiscal 1985: the deficit drops from $182.4 billion in fiscal 1983 to $127.3 billion in fiscal 1985.

We have assumed that for the rest of 1983 the Federal Reserve will maintain the somewhat tighter policy stance begun in the spring of this year. This will be reflected in slower growth of the monetary base—at an average annual rate of 4½ percent from June to December 1983 compared to a 12½ percent average annual rate during the previous 6 months—including an attitude of strong encouragement by the Fed for banks to borrow reserves through the federal funds market rather than at the discount window. We believe that this pressure to avoid the discount window is having approximately the same effect as raising the discount rate by about one half of a percentage point, while avoiding the possibly unsettling effects which an actual hike in the discount rate might have on the money markets. To simulate this effect in our econometric model, we have raised the discount rate to 9 percent for the last half of 1983.

If the economy moves through the rest of 1983 in a way which is broadly consistent with our forecast, we believe that the Federal Reserve will then ease up slightly both in the provision of reserves and by reducing the pressure to minimize borrowing at the discount window. We have simulated this by returning the discount rate to 8½ percent beginning in 1984:1 and by allowing the monetary base to grow at a 6 percent annual rate during 1984 and 1985.

We are assuming that real exports will continue to decline through the current quarter as the dollar remains strong and as recovery in most other major western economies lags our own recovery. As economies improve abroad we can expect some improvement in our exports over the remaining two years of the forecast with growth in real exports at an annualized rate of 3 percent by the second half of 1984 and on into 1985. This is robust growth compared to the downward trend that we have experienced in our exports thus far during the 1980s but well below the 10 percent average annual rate of growth which was posted for the last half of the 1970s.

Farm prices are assumed to increase at a moderate pace averaging 4½ percent (at annual rate) during the second half of 1983 and 6 percent per year for the rest of the forecast period.

In the short run the petroleum situation is not expected to contribute to inflationary problems for oil importing countries. Supplies should be plentiful as slow economic recoveries keep overall demand relatively low. We are assuming that oil prices will rise by 3 percent (at annual rate) during the last half of 1983 and at a 5 percent rate during 1984 and 1985.

Overview of the Forecast

The RSQE forecast is summarized in Tables 1 and 2. We begin with Table 1, which focuses on annual data. Based on the initial conditions and assumptions already discussed, the Michigan Model implies that the 1.9 percent drop in real GNP in 1982 will be followed by two years of substantial increases in real GNP amounting to 3.2 percent in calendar 1983 and 5.9 percent in 1984. The 1983 turnaround is paced by

1) sharply higher consumer spending, especially for durable goods—with automobile sales totaling 9.3 million units for the year compared with only 8 million units sold in 1982, and

TABLE 1: Overview of RSQE Forecast, Annual Data

	Calendar Year Averages			Percent Changes		
	Actual	Predicted				
Economic Indicator	**1982**	**1983**	**1984**	**1981-1982**	**1982-1983**	**1983-1984**
Real GNP and Components (billions of 1972 dollars)						
Real GNP	1485.4	1533.0	1623.4	−1.9	3.2	5.9
Consumption	970.2	1014.1	1055.2	1.4	4.5	4.0
Durable Goods	139.8	156.9	170.7	−1.0	12.2	8.8
Business Fixed Investment	166.1	164.0	184.4	−4.8	−1.3	12.5
Residential Construction	37.8	52.6	62.5	−15.4	39.1	18.8
Inventory Investment	−9.4	−1.1	18.4	—	—	—
Net Exports	28.9	8.9	−1.2	—	—	—
Government Purchases	291.8	294.5	304.2	1.8	0.9	3.3
GNP Deflator (1972 = 100)	206.9	216.4	227.2	6.0	4.6	5.0
GNP in Current Dollars (billions)	3073.0	3318.8	3688.7	4.0	8.0	11.1
Civilian Unemployment Rate (percent)	9.7	9.7	8.1	—	—	—
Capacity Utilization Rate, Manufacturing (percent)	71.1	74.9	82.1	—	—	—
Automobile Sales (millions of units)	8.0	9.3	10.5	−6.5	16.8	13.0
Corporate Profits* (billions of $)	164.8	217.0	284.9	−14.3	31.7	31.3
Real Disposable Income (bills. '72 $)	1060.2	1091.0	1126.3	0.5	2.9	3.2
3-Month Treasury Bill Rate (percent)	10.6	8.7	8.4	—	—	—
Aaa Corporate Bond Rate (percent)	13.8	12.0	11.7	—	—	—

*Includes inventory valuation and capital consumption adjustments.

2) a 39 percent increase in the level of residential building following four straight years of declining residential construction activity.

If all other components of real GNP held at their 1982 values, consumption and home building alone would raise real GNP by 4 percent this year. On balance, however, the other components contribute a slight negative to the change in GNP, with the largest of these being a $20 billion drop in the real value of net exports between 1982 and 1983. The U.S. economy has emerged earlier and more strongly from the 1981-82 recession than have our major trading partners (on the average), and international interest rate differentials are again pushing up the relative value of the American dollar. These factors have produced a major decline in our net export position, and that decline appears likely to continue—though at a very much diminished rate after late 1983—unless the dollar declines by a good deal more than appears likely in the context of the interest rates and growth path in our forecast.

The 5.9 percent growth of real GNP being forecast for calendar 1984 is much more evenly balanced across the GNP components than is the case for 1983. Business capital purchases are forecast to be up by 12½ percent in real terms for 1984 following declines of 4.7 and 1.3 percent for 1982 and 1983 respectively. Automobile sales are forecast to total 10½ million units in 1984, the first year with sales over 10 million units since the 10½ million cars sold in 1979.

Two years of substantial growth in output will result in much higher levels of resource utilization. The civilian unemployment rate is forecast to decline by 1.6 percentage points from its 1982 level to an average of 8.1 percent for 1984, while the level of capacity utilization in manufacturing is forecast to rise from a 71.1 percent average for 1982 to 82.1 percent for 1984.

Corporate profits (including inventory valuation and capital consumption adjustments) are expected to recover sharply during the economic expansion, rising from $165 billion in 1982 to $285 billion in 1984—or from 5.3 to 7.7 percent of GNP. The aggregate price level as measured by the GNP deflator is forecast to be up by 4.6 percent this year and by 5 percent for calendar 1984.

It is often the case that annual data mask a good deal of the underlying economic dynamics, and may even misrepresent those dynamics. Thus, as indicated in Table 1, total production (real GNP) in 1984 will exceed 1983's production level by nearly twice as much as 1983's level of production will exceed that of 1982. Yet, the growth rate in the economy will be higher during the early quarters of 1983 than during the later quarters of 1984—a pattern not revealed by Table 1. To get a sense of the path being forecast for the coming two years, we refer the reader to the summary data in Table 2.

The Dynamic Path in the Forecast

We are forecasting that the economic recovery and expansion which took hold in the closing months of 1982 will continue right through mid-1985. The expansion period covered by this forecast will be characterized by a rate of growth of real GNP diminishing from more than 7 percent (at annual rate) in the current quarter to about 5½ percent in the first half of next year, and to a pace of approximately 3 percent during 1985 (see Table 2). This path of production would be consistent with an unemployment rate averaging 8.9 percent in the closing quarter of this year, falling further to a 7.7 percent average in the closing quarter of 1984, and stabilizing at a level of about 7½ percent in mid-1985. The rate of inflation—now expected to be in the 4½-5 percent range at the end of this year—would begin to pick up in mid-1984 as employment and capacity utilization continue to increase. In the context of our forecast, which assumes no significant supply shocks, favorable or unfavorable, the rate of inflation is expected to reach the 5½-6 percent range by mid-1985.

The interest rate path shown in Table 2 is of particular relevance to an understanding of the output and employment path discussed above. The 9¼ percent treasury bill rate in 1983:3 is not primarily, or even largely, the result of unusually strong credit demands or a high and rising rate of inflation. Short-term interest rates have risen by 110 basis points since May because the Federal Reserve decided to push rates up by about that much. And it appears that the Fed wants to keep interest rates about where they are now at least long enough to see how economic activity reacts and how the federal budget develops. According to our model the economy will react by producing a somewhat lower growth rate in the third quarter of this year than in the second and a still lower rate of growth in the fourth quarter. Automobile sales and housing starts will both remain roughly at their current levels—about a 9.8 million unit auto sales rate and about a 1.7 million unit housing starts rate—during the second half of this year, while business capital purchases will begin to accelerate in response to the substantial improvement in business sales and increased capacity utilization. The federal deficit—which has been declining since the end of last year—will turn up in the current quarter due to the final stage of the Reagan tax cut, but the increase will be relatively small as the economy continues to expand; and the deficit is forecast to begin declining again in 1983:4.

If the Federal Reserve keeps interest rates at or above their current levels well into 1984, however, the chances of a much sharper reduction in the rate of economic growth will surely increase. And the chances of ending the economic recovery during 1984 will increase as well. But if the economy develops about as we have forecast for the next few quarters, there will not be much reason for the Fed to continue to tighten credit and push interest rates upward. Indeed, with the federal deficit declining, with inflation remaining low, with domestic growth proceeding in a fairly balanced process, with international financial imbalances constantly exerting pressure—and at this point some readers might wish to add "election year"—it might well be expected that the Fed would begin to back off and allow rates to come down, at least temporarily. Not by a great deal, but by enough, for example, to get auto sales and residential construction heading upwards again for most of 1984. This is the scenario shown in Table 2, and it represents our best judgement regarding the development of monetary policy and, given other inputs, the nature of the economic recovery during the coming year and a half to two years.

Uncertainties in the Environment

One day after the Labor Department announced the big drop in unemployment for July, we saw a newspaper headline that read "Interest rates cause alarm over recovery." The recovery following one of the worst recessions since the 1930s is a mere nine months old and already there's

TABLE 2: Summary of RSQE Forecast, by Quarter and Half-Year

Economic Indicator	1983:2-1983:3	1983:3-1983:4	1983:4-1984:2	1984:2-1984:4	1984:4-1985:2	1985:2-1985:3
Percent Changes at Annual Rate:						
Real GNP and Components (1972 dollars)						
Real GNP	7.3	6.2	5.6	4.5	3.3	2.6
Consumption	5.7	3.9	3.3	2.9	2.4	2.4
Durable Goods	12.7	7.8	7.6	3.6	0.6	0.7
Business Fixed Investment	7.1	12.8	13.9	14.5	11.0	7.1
Residential Construction	37.0	22.5	13.0	8.0	1.6	−0.2
Government Purchases	4.2	3.3	3.6	3.4	3.0	2.6
Wages, Productivity, and Prices						
Hourly Compensation, Private Nonfarm (1977 = 100)	5.1	5.6	6.6	6.3	7.3	7.0
Productivity, Private Nonfarm (1977 = 100)	4.1	3.4	3.3	2.4	1.5	1.1
Price Deflator, Private Nonfarm GNP (1972 = 100)	4.1	4.6	4.2	4.6	5.2	5.6
Personal Consumption Deflator (1972 = 100)	5.3	5.1	5.2	5.4	5.8	6.1
Level in Terminal Quarter:						
Civilian Unemployment Rate (percent)	9.3	8.9	8.2	7.7	7.5	7.5
Real Net Exports (billions of 1972 $)	3.6	1.1	−0.5	−3.1	−5.3	−6.1
Automobile Sales (millions of units)	9.8	9.8	10.6	10.7	10.3	10.2
Private Housing Starts (thousands)	1682	1744	1789	1867	1864	1850
3-Month Treasury Bill Rate (percent)	9.2	9.0	8.3	8.4	8.6	8.8
Aaa Corporate Bond Rate (percent)	12.3	12.3	11.8	11.5	11.4	11.3
Corporate Profits* (billions of $)	229.2	244.9	279.4	306.7	324.7	331.1
Profits as Percent of GNP	6.8	7.1	7.7	8.0	8.1	8.1
Federal Deficit (billions of $)	174.5	166.7	142.6	132.9	125.3	121.2

*Includes inventory valuation and capital consumption adjustments.

serious concern that interest rates may be getting too high for the expansion to be sustained!

High interest rates are just one of several factors which could kill the recovery but are unlikely to do so at any time soon. The automobile industry, for example, *could* decide that this fall would be a terrific time to raise car prices by 15 percent or more and to drop all the financing incentives at the same time. That would likely kill the car market and the economic expansion as well, but the industry is *not* very likely to opt for such extreme brinkmanship. A number of major labor unions could decide that now is the time to return to 1970s-style wage and work bargains. That would surely be disruptive and could well jeopardize the health of the expansion, but it's also extremely unlikely.

And, similarly, the Federal Reserve could overdo its tighter credit policy. Quite clearly, the Fed wants to convince the money markets that it is prepared to do its part in supporting an orderly, sustainable, non-inflationary expansion. That is supposed to calm the markets. But the money markets are extremely nervous—made that way by the authors of the outyear deficit problem, the same federal government of which the Federal Reserve is a part. Does the Fed know something which the money markets should know? Is the federal deficit about to run up to levels of which the extreme pessimists have long warned? Is that why the Fed is beginning to push rates up? In a money market already prepared to believe the worst, it's easy to imagine that Federal Reserve policy could have consequences other than or beyond those desired by the Fed.

Yes, it appears that the chances of the recovery ending in 1984 are a bit higher than would be consistent with historical norms. The political/economic turmoil of recent years has made our economic environment riskier, less easily predictable. Yes, it is possible; but *no,* we do *not* regard it as likely that the 1981-82 recession will be followed by a recovery that lasts less than two years.

August 1983

Results from the May NABE Survey

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Another survey of National Association of Business Economists (NABE) members—the latest on which we can report—was conducted in May. As mentioned before, these quarterly surveys, which began in May 1982, solicit forecasts of various economic series and opinions about current economic policy matters.

Economic Forecasts

Table 1 displays median values of forecasts for selected economic series asked about in May. Real GNP was expected to increase by about 4 percent from 1982:4 to 1983:4 (up a bit from the 3.8 percent given in February), consumer prices were expected to increase by about 4 percent during the same four-quarter period (down over a percentage point from February), and real fixed investment was forecast to increase by nearly 3 percent (up from about zero change expected in February). Answers to other questions not displayed in the table indicated that the rate of increase of both GNP and prices was expected to be greater in the second half of this year than in the first half; similar expectations were given in February. The expected long-run inflation rate (CPI over the next decade) continued to creep down from values given in the previous surveys, but not by much (e.g., from slightly over 6 percent in February to slightly under that figure in May). Business economists seem not yet entirely convinced that the substantially lower inflation rates enjoyed during the past year or so are the beginning of a long-run trend.

NABE forecasters saw the unemployment rate as being just below 10 percent by the end of the year, not much changed from their February expectation. But the anticipated end-of-year prime rate did decline by about 70 basis points, to 10.2 percent. New private housing starts were expected to average about 1.6 million units during the fourth quarter, and auto sales were to be around 9.2 million units then (both quantities at annual rates). These latter two projections were, respectively, about 100,000 units higher and 400,000 units lower than the analogous February ones; subsequent events in the auto markets will probably reflate the auto projections in the next survey.

TABLE 1. Forecasts of Selected Economic Series, May 1983

Series	Median Value
Annualized Percent Change:	
Real GNP, 1982:4-1983:4	4.1
Consumer Price Index, 1982:4-1983:4	3.9
Real Fixed Investment, 1982:4-1983:4	2.7
Percent:	
Unemployment Rate, 1983:4	9.9
Prime Rate, 12/31/83	10.2
Millions of Units:	
New Private Housing Starts, 1983:4	1.6
Automobile Sales, 1983:4	9.2

Our NABE respondents are classified according to their primary affiliation in six groups: manufacturing, nonbank finance, trade associations and others not elsewhere classifiable, government and academic, commercial banking, and consulting. No substantial differences in their economic forecasts were noted among the groups, though those in the nonbank finance field saw both output and prices increasing somewhat more rapidly than the others.

Fiscal and Monetary Policy

As in the earlier surveys, several questions concerning fiscal and monetary policy were asked in May. The questions in May about the relative looseness/tightness of recent policy were, "What is your view about current fiscal policy—is it too stimulative, too restrictive, or about right?" and "What is your view about recent monetary policy actions—have they been too stimulative, too restrictive, or about right?" Concerning fiscal policy, there was very little change in the distribution of opinion from February to May, with the substantial majority (about two-thirds) continuing to see fiscal policy as too stimulative. (Those in the nonbank finance and government/academic groups were least likely to view the policy as too stimulative, through here too a solid majority—almost 60 percent—held that view.)

Concerning monetary policy, there was a slight shift in May toward seeing it as about right as opposed to too restrictive, but the differences are hardly dramatic. (Government/academic and consulting economists were somewhat less likely than the others to select the "about right" viewpoint, but the former had about equal numbers in the "too stimulative" and "too restrictive" categories, while the latter had about four times as many in the "too stimulative" as in the "too restrictive" cells.) A final question on monetary policy asked about Federal Reserve policy, "Do you think the current [judgmental] approach should be continued or should the Fed return to its previous method of greater emphasis on targeting one or more of the monetary aggregates?" By just about a two-to-one margin, the business economists endorsed the current judgmental approach. Most in favor of this were economists in the trade associations/"other" and the government/academic groups; least in favor were the commercial banking and consulting groups, though even among these three-fifths favored the judgmental approach.

Several additional questions touched on various aspects of fiscal policy. One asked whether the respondent favored new policy initiatives to eliminate federal budget deficits by 1988. About three-quarters did favor such initiatives, with only the manufacturing and government/academic groups being relatively less enthusiastic (around 60 percent versus around 80 percent of the others). Those who said they favored actions to eliminate the deficits were asked

whether they would prefer "actions to reduce expenditures as a percent of GNP, actions to raise revenues as a percent of GNP, or some of both?" A majority favored emphasizing expenditure reduction as the way to tackle the deficits, with only about 6 percent wanting to emphasize "revenue enhancement"; about 40 percent would look equally to expenditure control and tax increases as the best course of action.

Two questions concerning tax policy were posed in the May survey. The business economists were asked for their preferred course of action concerning the (then) scheduled July 1st tax cut and whether they favored maintaining the indexation of the tax rate structure scheduled for 1985. There was substantial majority support for going ahead with the tax cut, with other responses pretty well scattered among the cancel, postpone, reduce, and inpose-a-ceiling options. The government/academic economists were the only group where less than half favored going ahead, and nearly a quarter would have cancelled the cut.

On the indexation question, over 70 percent favored maintaining this automatic adjustment of taxes beginning in 1985; those in manufacturing were most preponderant in their support, while those in nonbank finance were least so.

The economists were again asked whether the social security reform package had solved the system's long-run funding problem (they had been asked this, among other questions about the reform package, in February). Only about 12 percent believed that the funding problem had been solved by the new law, down sharply from the (already low) 26 percent who expressed that viewpoint three months earlier.

Functioning of the Economy

Two questions asking for the business economists' opinions about the way the economy operates appeared in the May survey; responses appear in Table 2. Queried about what really affects prices—nominal GNP or money supply—the NABE members came down rather strongly on the side of prices, with nearly half saying prices are "mainly" or "totally" a function of money. Less than a quarter saw prices mainly or totally dependent on changes in nominal GNP. Particularly interesting here is the substantial divergence of opinion between the government/academic economist and the others, with the former being substantially more likely to select nominal GNP as the primary price-level setter.

The second question asked "whether fiscal policy has an independent effect on real output, whether fiscal effects only occur when monetary policy is facilitative, or whether macroeconomic policies generally are ineffective in changing the level of real output." Here equal proportions (37 percent) said that fiscal policy operates independently and that it needs a facilitative monetary policy, with less than 15 percent seeing it as ineffective. Again those economists associated with government or academic institutions gave a different pattern of responses; they were much more likely than the others to see fiscal policy as having effects on real output independent of monetary policy.

TABLE 2. Percentage Distribution of Responses to Questions about the Economy's Functioning by Primary Affiliation of Business Economists

	Primary Affiliation Group						
Response Category	**Manufacturing**	**Nonbank Finance**	**Trade Associations & "Other"**	**Government & Academic**	**Commercial Banking**	**Consulting**	**All Groups**
What Really Affects Prices?[1]							
Nominal GNP Totally	4	7	13	20	10	19	11
Nominal GNP Mainly	13	16	5	17	12	8	11
Both GNP & Money	29	19	22	29	17	22	23
Money Mainly	45	42	38	23	45	47	41
Money Totally	4	3	8	3	7	3	5
Other Responses	5	13	13	8	10	0	9
How Does Fiscal Policy Affect Output?[2]							
Operates Independently	35	37	29	54	40	28	37
Needs Facilitative Monetary Policy	37	27	51	23	32	44	37
Is Generally Ineffective	18	20	11	14	13	8	14
"Depends"; Other Responses	10	16	9	9	15	20	12

[1]"Economists have always disagreed about the links between money and prices, and about the implications of this for monetary targets. Some have argued that changes in nominal GNP or expenditures are really what affects prices, while others have argued that money itself is really what affects prices. Where do you stand in this ongoing debate?"

[2]"Another ongoing debate is whether fiscal policy has an independent effect on real output, whether fiscal effects only occur when monetary policy is facilitative, or whether macroeconomic policies generally are ineffective in changing the level of real output. Where do you stand in this debate?"

Poverty and Welfare Dependence Across Generations

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Introduction

Culture-of-poverty, underclass, and welfare-dependency theories emphasize the *permanence* of the states of poverty and welfare dependence. This permanence, in fact, is seen as extending from one generation to the next. These theories maintain that poverty and welfare dependence are transmitted intergenerationally largely because values and motivations deemed vital to economic achievement—autonomy, independence, ambition, concern for the future, and coping—are not reinforced during a childhood spent in poverty and dependence on welfare. For the culture-of-poverty theories (developed in the 1960s) it is poverty or the lack of income itself that fosters attitudinal and psychological deficits which inhibit intergenerational income mobility among the poor. (These theories also stress reciprocal causation: that poverty is an outcome of attitudinal deficits, as well as a cause.) For the more recent welfare-dependency theories and portions of the underclass theories, the government's cure for the poverty problem, the welfare system, is viewed as causing and reinforcing attitudinal and psychological deficits which inhibit intergenerational economic achievement.

This discussion reports our findings regarding the transmission of poverty and welfare dependence across generations, and the role of parental attitudes and motivations in this transmission. Because of space limitations we will only briefly present our findings concerning cross-generational poverty transmission, concentrating instead on the cross-generational welfare dependency results and how they were obtained.

The Data Source

All results are based on our analysis of a data set uniquely suited for intergenerational analysis, the Panel Study of Income Dynamics (PSID) data on "splitoff" children. (Frequent readers will recall several other articles which have been based on parts of the rich PSID data archives.)

We have a 14-year time span of information about the economic situation of a representative set of children who left parental homes since 1968. Specifically, the individuals were between the ages of 25 and 30 in 1981 (12-17 in 1968), lived with at least one parent or grandparent in 1968, and had non-missing information on the key parental background measures. With these restrictions, the sample consisted of 1391 offspring as young adults. To test for differences by race and gender, we stratified the full sample into 4 subgroups—black women, black men, white women, and white men. For all these individuals, we have detailed parental information, including long-term poverty and welfare dependence and attitudinal measures reported by the parents themselves. We also have long-term poverty and welfare information about the children reported by themselves as young adults. On average, a child spent 7 years in the parental house before leaving and forming his or her own household.

Cross-generational Income Mobility Results

The culture-of-poverty and underclass theories emphasize intergenerational persistence of poverty. An important question to answer is, therefore, how much income mobility do the poor enjoy? There was substantial *upward* mobility among young adults from poor families, where a parental family was defined as poor whenever the ratio of family income to needs, averaged over the entire period during which the child lived with his/her parents, was in the lowest quintile. The majority, 57 percent, of such young adults were not impoverished (that is, weren't in the lowest income/needs quintile) themselves after leaving home (see Table 1). Further, most of those who escaped poverty were not clustered slightly above the poverty line. This is not to say that the poor are not at greater risk of being poor in the next generation. Certainly they are; children from families in the lowest income/needs quintile were about 3 times more likely than those from other families to have their own income/needs in the bottom quintile as adults. (We arrived at this by summing the percentages from the second through fifth columns of the first row of Table 1 and dividing them by the summed percentages from the same columns of the bottom row, coming up with a figure of about 13 percent poor offspring from nonpoor families. This is about one-third of the 43 percent poor from poor families.)

To test if differences in parental motivation and values are at the root of the greater likelihood of poor children's

TABLE 1. Percentage Distribution of Young Adults by Parental Family Income/Needs Quintile and Own Family Income/Needs Quintile

Own Family Income/Needs Quintile[1]	Parental Family Income/Needs Quintile[2]					
	Lowest	Fourth	Third	Second	Highest	All
Lowest	8.7 (43.3)[3]	4.3 (23.2)	2.5 (13.1)	2.1 (10.7)	1.8 (9.2)	19.3
Fourth	5.4 (26.9)	4.5 (24.1)	5.2 (23.3)	3.4 (17.2)	2.5 (13.2)	21.0
Third	3.6 (18.2)	3.5 (19.0)	5.1 (22.7)	4.3 (21.7)	3.6 (18.9)	20.2
Second	1.9 (9.4)	3.6 (19.3)	5.8 (26.1)	5.1 (25.5)	4.4 (23.1)	20.8
Highest	0.4 (2.2)	2.7 (14.3)	3.8 (16.8)	5.0 (24.9)	6.8 (35.6)	18.6
All	20.0	18.6	22.4	20.0	19.1	100.0

[1]The quintiles for own family income/needs represent the following ranges of income/needs: lowest, 0-1.99; fourth, 2.00-2.80; third, 2.82-3.54; second, 3.55-4.39; highest, 4.40 or more.

[2]The quintiles for parental family income/needs represent these ranges of income/needs: lowest, 0-1.49; fourth, 1.50-2.26; third, 2.27-3.16; second, 3.17-4.35; highest, 4.36 or more.

[3]Numbers in parentheses indicate percent of the column group. The total number of observations is 1480.

becoming poor adults, we used a multiple regression technique to analyze the effect on young adults' economic attainments of three measures of parental attitudes—personal efficacy, orientation toward the future, and achievement motivation—and a variety of parental background variables generally used in status attainment models. Parental attitudes and values with few exceptions had no effect on children's later economic outcomes. No attitude had a consistent effect across any subgroup analyzed, and for no subgroup did the attitudes work in a consistent manner as predicted by the theories. (See Table 2. The number -.255 in the top left cell would mean, if significant, that white males whose parents measured highest on the "efficacy" scale had an income-to-needs ratio .255 lower than those whose parents measured lowest on the scale, after the regression adjusted for the effects on the other included variables. But the low t-ratio indicates that this relationship is not statistically significant.)

To summarize these cross-generational income mobility results: While children from poor households are more likely to be poor as young adults, there was substantial upward income mobility among these young adults from poor families. Parental attitudes and values, with few exceptions, did not make any difference in the economic well-being of children after they left home.

TABLE 2: Regressions of Young Adults' Income/Needs on Parental Attitudes (t-ratios in parentheses)

Parent's Attitudes	White Males	Black Males	White Females	Black Females
Efficacy	-.255	-.003	.440*	-.126
	(1.15)	(0.01)	(2.16)	(0.49)
Future Orientation	.383	-.215	.204	-.070
	(1.50)	(0.75)	(0.95)	(0.25)
Achievement Motivation	.044	.093**	-.013	.025
	(1.55)	(2.89)	(0.53)	(0.84)
R^2	.173	.162	.182	.175
Number of Observations	319	258	378	300

Note: Other variables included in the analysis are age in 1981, father's education, mother's education, number of siblings, parent's IQ test score, religion, city size in 1968, region in 1968, parental family permanent income/needs, whether mother-only home in 1968 or some other time before left home, and four dummy variables representing level of parent's welfare dependency.

*Significant at .05 level.

**Significant at .01 level.

Cross-generational Welfare Dependency Results

A portion of the underclass is sometimes viewed as a welfare class, which passes on a legacy of welfare dependency to its children. The development of such a welfare class is seen as a danger of the welfare system. Whether there is a link between parental welfare dependency and children's later welfare dependency as adults, and whether parental attitudes predict either welfare use or welfare dependency of children when they become adults, are questions which have not been thoroughly answered. Past empirical studies of this topic have suffered largely from inadequate data.

Case studies have been used as evidence that intergenerational transmission of welfare dependency operates on a large scale, with poor attitudes of the parents cited as the root of the problem. Cross-sectional studies have looked only at current welfare recipients, asking them about their parent's welfare receipt. Finding that a certain percentage grew up in welfare-dependent families, the analysts conclude that the necessary link is established. The longitudinal studies performed have correctly included both current welfare recipients and nonrecipients, but they were of too short a length to provide representative sampling of the offspring. Our analysis is able to overcome these inadequacies since we are able to follow the economic circumstances of a nationally representative sample of children as they grow up and become adults. It is only with data such as these that the extent of intergenerational transmission of welfare dependence, and the role of parental attitudes and motivations in this transmission, can be properly ascertained.

The outcome of interest is the young adult's welfare status, measured as the fraction of permanent income that was in the form of welfare, where welfare included Aid to Dependent Children and Aid to Families of Dependent Children (ADC/AFDC), Supplemental Security Income (SSI), other welfare, and foodstamps. Parental background factors are treated as predictors of this variable. These predictors include (1) a parental welfare dependency measure, (2) parental attitude measures, and, as in the income mobility analysis, (3) a set of background measures that are customarily used in attainment models. The parental welfare dependency measure, like the offspring's welfare dependency measure, reflects the fraction of permanent income in the form of welfare. A set of one-zero "dummy" variables is used to represent this variable in order to capture possible nonlinearities in the relationship. The parental attitude measures are the ones already mentioned: parental efficacy, orientation toward the future, and achievment motivation, these defined in greater detail below.

Two measures from the PSID were used as measures of parental efficacy. Points were given for expressing sureness that "your life will work out the way you wanted it to" and "thinking your plans work out." Three items from the PSID were used as measures of future orientation. Points were given for "planning your life ahead," "thinking about things that might happen in the future," and "preferring to save money for the future." Sixteen items from the PSID were used as measures of achievement motivation. The items focus on four characteristics: points were given for expressing preference for challenging versus affiliation outcomes, expressing preference for challenging versus power outcomes, wanting one's child to be an achiever, and not fearing failure.

An initial question to address is to what extent is there a high degree of long-term parental dependency on welfare. As in previous studies of long-term welfare dependency we find that, while exposure to welfare is fairly pervasive, long-term dependency on welfare is rare (see Table 3). Ex-

amining the last column of Table 3, we find that one-quarter grew up in a household that received welfare income at some time, but only about 4 percent (1.7 + 2.1) were in households where welfare income accounted for over half of the total income of their parents. Only about 7 percent were in households where welfare income accounted for more than one-quarter of parental income.

Both welfare receipt and especially high levels of welfare dependency were more common among black children than white children. Blacks were 8 times more likely to be raised in long-term welfare-dependent homes (where parents received more than half of total income as welfare) than were whites (16 percent versus 2 percent). Thus, although high levels of parental welfare receipt are rare, black children are much more likely to encounter them than white children.

These race differences in parental welfare dependency have important practical implications for our analysis. Only 10 white men and 13 white women in our sample were raised in homes where welfare constituted 50 percent or more of family income. Because of the paucity of cases for whites, we look only at black women and black men in the subsequent analyses. There were 58 black women (out of 309) and 54 black men (out of 268) in our sample in what we define as welfare-dependent households (with more than half of total income from welfare).

In order to properly analyze the relationship between parental welfare dependency and offspring's welfare dependency, in a multivariate context, it is necessary to use the "inverse Mill's ratio" estimation method (attributed to J. Heckman). This method is appropriate for the type of dependent variable under analysis—a limited dependent variable which arises due to sample censoring. The value of offspring's welfare dependency that we observe, because it is a ratio of welfare income to total income, either can take on a value of zero (if no welfare was received) or can take on any of the continuous positive values less than or equal to unity (if some welfare was received). Parental welfare dependency potentially influences *both* whether the young adult receives welfare *and* the degree of the young adult's welfare dependency once welfare has been received. Using ordinary least squares regression to estimate the relationship with the full sample of observations or restricting the sample only to young adults with some welfare receipt would produce biased estimates. The estimates would be biased because the effect of parental welfare receipt on the *degree* of the young adult's welfare dependency would be confounded by its effect on whether or not the young adult received welfare.

TABLE 3: Weighted Percentage Distribution of Young Adults by Parental Welfare Dependency Level

Parental Welfare Dependency Level	White Women	Black Women	White Men	Black Men	All
Never Received	37.6	2.3	33.3	2.0	75.2
1-25% Dependent	6.9	2.3	7.1	1.9	18.3
26-50% Dependent	0.7	0.7	0.8	0.6	2.8
51-75% Dependent	0.3	0.6	0.6	0.2	1.7
76-100% Dependent	0.7	0.5	0.3	0.4	2.1
All	46.2	6.3	42.2	5.3	100.0

If there were intergenerational transmission of welfare dependence, one would expect one of 3 types of patterns to emerge. The first would be simply a pattern in which parental welfare receipt at any level contributed to the level of offspring welfare dependency. This would mean fairly constant effects regardless of the level of parental welfare dependency for parents receiving any welfare. The second pattern would be one in which the parental welfare dependency level contributed monotonically to the level of offspring welfare dependency. The third pattern would be one in which the highest level of parental welfare dependency, but not the low levels, raised the level of offspring welfare dependency.

The results of this analysis appear in Table 4. There is no support for any one of the putative patterns. Examining the second and third columns one observes no consistently significant effects of parental welfare receipt on children's welfare receipt for either black women or black men, whether or not parental attitudes were controlled for. (The first number in the left column, .003, implies that black women from families which received 1-25 percent of their total income as welfare had an own welfare-to-total-income ratio .003 higher than black women from families

TABLE 4. Effects of Parental Welfare Dependency on Offspring's Welfare Dependency

Parental Welfare Dependency	Heckman-Corrected (with probit) Ordinary Least Squares Regression Coefficients/(t-ratios)	
	Without Attitudes	With Attitudes
Black Women:		
(Never Received)	—	—
1-25% Dependent	.003/(0.05)	-.015/(-0.24)
26-50% Dependent	.144/(1.59)*	.130/(1.43)
51-75% Dependent	.067/(0.65)	.062/(0.60)
76-100% Dependent	.060/(0.56)	.044/(0.41)
F-value	0.99	—
R^2 (log likelihood)	.226	.250
Number of Observations	180	180
Black Men:		
(Never Received)	—	—
1-25% Dependent	-.010/(-0.22)	-.011/(-0.26)
26-50% Dependent	-.087/(-1.34)	-.087/(-1.27)
51-75% Dependent	.010/(0.14)	.018/(0.25)
76-100% Dependent	.008/(0.12)	.014/(0.20)
F-value	0.79	—
R^2 (log likelihood)	.156	.196
Number of Observations	92	92

Note: Other variables included in the analysis are age in 1981, father's education, mother's education, number of siblings, parent's IQ test score, religion, city size in 1968, region in 1968, parental family permanent income/needs, and whether mother-only home in 1968 or some other time before left home. *Attitude measures* include parent's efficacy, parent's achievement motivation, and parent's future orientation.

*Significant at .10 level.

which never received welfare—the "excluded group" in this regression. But the low t-ratio indicates that this implied relationship is far from statistically significant. The next coefficient in this column is the only significant association in the table—and that only marginally so.) Blacks from welfare-dependent families were no more likely to become welfare-dependent than similar blacks from families who had never received welfare. Further, measures of parental sense of efficacy, future orientation, and achievement motivation had no significant effects on welfare dependency for either group. (See Table 5. The first number, -.017, would, if significant, indicate the decrease in the offspring's welfare-to-total-income ratio associated with the highest parental scores on the achievement motivation scale. But the t-ratio demonstrates that the implied relationship just may be significant.) We also explored whether blacks from welfare-dependent families had a poor work ethic by regressing labor income and work hours on measures of parental welfare dependency. There were no significant negative effects of parental welfare receipt on young blacks' labor income or work hours for either men or women.

TABLE 5. Effects of Parental Attitudes on Offspring's Welfare Dependency

Attitude Measures	Heckman-Corrected (with probit) Ordinary Least Squares Regression Coefficients/(t-ratios)
Black Women:	
Achievement Motivation	-.017/(-1.75)*
Efficacy	-.022/(-0.25)
Future Orientation	.141/(1.54)
F-Value	1.74
Black Men:	
Achievement Motivation	-.005/(-0.64)
Efficacy	.071/(1.32)
Future Orientation	.622/(0.99)
F-Value	1.24

Note: Other variables included in the analysis are age in 1981, father's education, mother's education, number of siblings, parent's IQ test score, religion, city size in 1968, region in 1968, parental family permanent income/needs, whether mother-only home in 1968 or some other time before left home, and parent's welfare dependency.
*Significant at .10 level.

Summary

Our results do not support the intergenerational arguments of the culture-of-poverty, underclass, and welfare-dependence theories. We observe a great deal of income mobility from one generation to the next, even among the poorest households. Links between parents' and children's economic circumstances do exist. However, long-term welfare dependency as a child does not cause long-term welfare dependency as an adult, at least among blacks. Parental attitudes and values had little effect on children's later economic outcomes and welfare dependence.

Premature Affluence: Do High Schools Students Earn too Much?

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The typical high school student today holds a part-time job. Among seniors, more than three-quarters work during the school year. Indeed, about one-third of the males and one-quarter of the females report that they average more than twenty hours per week at work.

Until very recently these proportions have been steadily rising, generally with the blessing of parents, teachers, and social scientists. Many have argued that employment is a positive experience for young people. It gets them out of the "artificial" environment of the classroom and into the "real world." It puts them in contact with a wider range of people of different ages and socioeconomic levels. It teaches lessons of punctuality, reliability, responsibility, and other practical skills involved in getting and holding a job. And, of course, it teaches the value of a dollar. These are some of the advantages that many of us felt would be gained if young people spent somewhat less time in classrooms during their later teens and more time in employment situations.

Now that such a change has actually taken place, concerns are being raised as to whether the trend may have gone too far—at least for some young people. Based on studies of high school students in Orange County, California, Ellen Greenberger and Laurence Steinberg, along with several colleagues, have tried to sort out some of the consequences of teenage employment. Although their sample is not nationally representative, their findings are likely to be broadly applicable; and the concerns they raise need to be taken seriously. In particular, their data suggest that when high school students work more than 15 or 20 hours per week in part-time jobs, the negative effects outweigh the positive ones. Some of the negative effects include dimin-

ished involvement with school, family and peers, as well as increased use of cigarettes and marijuana.[1] Our own nationwide studies of high school seniors confirm the latter finding: drug use is positively associated with the number of hours worked in part-time jobs.[2] (Incidentally, while the increased income resulting from longer hours is one obvious explanation of the higher rates of drug use, both studies find that some correlation remains between hours of work and drug use even when income is statistically controlled.)

Earning and Spending among High School Seniors

Lloyd Johnston, Patrick O'Malley, and I have been surveying high school seniors since the mid-seventies in a study called Monitoring the Future. As Table 1 shows, the number of hours worked was rising during the late seventies, has declined somewhat during the eighties, but still remains impressively high. (We are not sure about the cause of the recent downturn—it could reflect a rising priority placed on schoolwork, but a more likely explanation is that it is just another aspect of overall high unemployment.) The other set of figures in Table 1 is also impressively high—the amounts of weekly earnings of some high school seniors. The rapid rise in earnings during the late seventies is partly the result of increases in the minimum wage and other inflationary factors, but it also is influenced by the increased numbers of hours worked by high school students. From 1979 onward, more than half of the male seniors who worked averaged over $50 per week; the figure was not much lower for females, who average fewer hours but enjoy about the same hourly rates. The highest category included in most of our surveys was $51 or more per week. In 1982 we added several more categories and found that 7 percent of the males and 3 percent of the females reported weekly earnings averaging more than $125, while another 18 percent of males and 12 percent of females reported earnings between $76 and $125.

For some time we have been interested in what young people do with all this money. A fairly popular assumption these days is that students should have a great deal of freedom in spending their part-time earnings, so that in making their own choices and occasionally their own mistakes they will get some reality experiences and "learn the value of a dollar." This is an attractive notion, at least in the abstract. In practice, however, it may be problematic. The problem is that the "reality" faced by the typical high school student with substantial part-time earnings is just not very realistic. In the absence of payments for rent, utilities, groceries, and the many other necessities routinely provided by parents, the typical student is likely to find that most or all of his/her earnings are available for discretionary spending. And given that many are earning in excess of $200 a month, it seems likely that some will experience what I've come to call "premature affluence"—*affluence* because $200 or more per month represents a lot of "spending money" for a high school student, and *premature* because many of these individuals will not be able to sustain that level of discretionary spending once they have to take on the burdens of paying for their own necessities.

Until recently these ruminations about premature affluence have been mostly speculative, prompted by our data on earnings plus some rather unsystematic observations of young people and their spending patterns. In 1981 we added a few questions to our surveys of high school seniors in order to get a clearer picture of the ways in which they were spending their often substantial earnings. The results proved generally consistent with our speculations.

[1]See, for example, E. Greenberger and L. Steinberg, "The Workplace as a Context for the Socialization of Youth," *Journal of Youth and Adolescence* (1981:10), pp. 185-210, and L. Steinberg, E. Greenberger, L. Garduque, M. Ruggiero, and A. Vaux, "Effects of Early Work Experience on Adolescent Development," *Developmental Psychology* (1982:18), pp. 385-395.

[2]J. Bachman, L. Johnston, and P. O'Malley, "Smoking, Drinking, and Drug Use among American High School Students: Correlates and Trends, 1975-79," *American Journal of Public Health* (1981:71), pp. 59-69.

TABLE 1. High School Seniors' Work Hours and Earnings, Classes of 1976-1982
(Entries are Percentages)

	Males[1]							Females[2]						
	1976	1977	1978	1979	1980	1981	1982	1976	1977	1978	1979	1980	1981	1982
On the average over the school year, how many hours per week do you work in a paid or unpaid job?														
None	21.2	19.0	18.1	15.4	16.5	19.0	20.4	30.7	28.3	25.7	24.1	22.8	23.8	26.4
1-10 hours	20.7	19.4	19.0	18.0	18.4	19.8	20.9	22.1	20.2	19.5	19.2	18.3	20.4	20.8
11-20 hours	23.1	22.2	23.5	24.6	26.3	26.1	25.8	23.5	26.4	26.8	28.3	30.8	29.3	28.3
21-30 hours	20.4	23.0	23.4	26.7	25.4	22.7	21.9	16.5	17.9	19.8	20.5	20.4	19.6	18.0
31 + hours	14.6	16.5	16.0	15.3	13.3	12.4	11.0	7.2	7.4	8.1	8.0	7.7	7.0	6.4
During an average week, how much money do you get from a job or other work?														
None	24.3	22.0	19.4	17.9	19.0	22.2	22.7	34.1	31.4	28.0	27.2	25.4	27.4	30.3
$1-20	21.1	18.6	15.9	13.3	12.9	13.2	14.2	22.8	19.6	17.7	15.1	14.2	15.6	15.1
$21-50	30.8	30.4	27.4	26.2	25.8	23.6	21.2	31.7	33.7	33.4	31.6	30.2	26.6	23.1
$51 +	23.8	29.1	37.3	42.5	42.4	41.0	41.9	11.5	15.2	20.8	26.0	30.2	30.4	31.6

[1]Number of cases ranged from 6600 to 8400.
[2]Number of cases ranged from 6600 to 8900.

Table 2 displays the 5 spending questions and the answers given by seniors in the class of 1982. The first item indicates that half of them do no saving for future education, and only about one in ten saves more than half of his/her earnings for that purpose. There is, of course, some difference related to future educational plans. Among those expecting to complete four years of college, 38 percent saved none of their earnings for that purpose, and only 15 percent saved most or all.

For many high school students a car represents a substantial current expense or future goal, as the second question in Table 2 indicates. Among males, it clearly outranks future education as an outlet for present earnings, whereas among females saving for education ranks very slightly higher. The extent of saving for other long-range purposes seems very similar to saving for education—half do no such saving, and only about one in twelve sets aside more than half of earnings for such purposes (see question C in Table 2).

The last question shown in Table 2 deals with the extent to which seniors' earnings are used to help with family expenses. Over half report making no such contributions, one quarter report contributing "a little," and only one in twenty contributes more than half of earnings.

This leaves us with the fourth question in Table 2, dealing with the kinds of spending which are most relevant to our concerns about premature affluence. As we anticipated, seniors report spending substantial portions of their earnings on clothing, stereos, TVs, records, other possessions, movies, eating out, other recreation, hobbies, gifts for others, and other personal expenses. If we consider that much of the spending in these areas is discretionary, and if we also assume that much of the spending and saving related to cars goes beyond what might be described as necessary, then the picture seems fairly clear that many high school seniors (and, presumably, many of those in earlier grades) are spending quite a bit of money on things like dressing well and having a good time.

TABLE 2. High School Seniors in 1982: Where their Earnings Went (Entries are Percentages)

	Males[1]	Females[1]
Please think about all the money you earned during the past year, including last summer. About how much of your past year's earnings have gone into:		
A. Savings for your future education?		
None	48	50
A little	23	21
Some[2]	19	19
Most[3]	11	10
B. Savings or payments for a car or car expenses?		
None	35	58
A little	19	16
Some[2]	29	18
Most[3]	17	9
C. Other savings for long-range purposes?		
None	48	48
A little	26	25
Some[2]	18	20
Most[3]	8	8
D. Spending on your own needs and activities—things such as clothing, stereo, TV, records, other possessions, movies, eating out, other recreation, hobbies, gifts for others, and other personal expenses?		
None	4	5
A little	21	17
Some[2]	38	34
Most[3]	36	44
E. Helping to pay family living expenses (groceries, housing, etc.)?		
None	56	55
A little	26	25
Some[2]	13	14
Most[3]	5	6

[1]Numbers of cases are approximately 1500 for males and 1520 for females.
[2]Combines two categories: "Some" and "About half."
[3]Combines three categories: "Most," "About all," and "All."

What Happens after High School?

So much for the evidence on teenage affluence—now what about the idea that this affluence is *premature*, and will be difficult to sustain in young adulthood. Here our evidence at present is much more limited. The Monitoring the Future study, in addition to surveying a large sample of high school seniors each year, also has conducted mail follow-up surveys of smaller samples of each graduating class since 1976. Since most of the follow-up questions are identical to those asked in the senior year, it is possible to examine changes that occur during the years following graduation. In the early stages of an analysis examining various sources of life satisfaction, we discovered one dimension which seems to decline fairly steadily during the years after high school: satisfaction with standard of living. Scores were generally fairly high among the high school seniors, averaging about 5.7 on a 7-point scale (the standard deviation is about 1.5). The ratings slipped by about .3 to .4 during the first year or two following graduation. Among those who continued as full-time students (many of whom also held part-time jobs), the decline continued: ratings of living standard had dropped by .6 for those three years beyond high school and by 1.0 for those 4 to 6 years beyond high school. Among the other graduates—those who were not full-time students—the decline was less sharp: ratings for those 4 to 6 years beyond high school were about .5 lower than their ratings as seniors.

Some other bits of longitudinal evidence also suggest that the full-time students after high school are a bit less likely to feel that they have enough money, compared to their ratings as seniors; among the non-students, there is a slight shift in the opposite direction. (Interestingly, the effect of these changes is to make the two groups nearly equal *after* high school, whereas during their senior year the college-bound were somewhat more likely than their classmates to say they had sufficient money for their needs.)

Summary and Conclusions

The analyses summarized above provide some support for the view that many high school students experience some degree of premature affluence—they earn a lot of money, they spend much of it on their own entertainment (broadly construed), and at least some of them experience a decline in their standard of living during the years immediately following high school. It must be acknowledged that these analyses thus far are quite limited; nevertheless, we judge the data clear enough, and the issues important enough, to warrant this early reporting.

Do these earning and spending patterns among high school students represent problems worth worrying about? I can distinguish two broad areas for concern:

1) the impacts of these experiences *during* the high school years, and
2) the *longer-range* impacts of the spending habits and tastes developed during the high school years.

As to what happens during the high school (and junior high school) years, I have already noted the concerns expressed by Greenberger and Steinberg that working fairly long hours at part-time jobs may interfere with some of the primary "developmental tasks" of adolescents, by reducing their involvements with family and with the academic and extra-curricular activities that go on in school. Additionally, it has been argued that the large amounts of discretionary income in the hands of adolescents has led to a sort of "separate youth culture" reflected in all sorts of products, including designer jeans, movies targeted at youth audiences, and records, tapes, and high-powered stereo systems which may systematically damage the hearing of a whole generation.[3] And, of course, the ready availability of cash makes it easier for young people to acquire alcohol, marijuana, and other drugs, as well as automobiles which increase mobility, relative isolation from adults, and accompanying risks. In sum, it can be argued that earning and spending patterns during high school can involve physical risks (e.g., drug abuse, death or injury on highways) and may also interfere with important developmental processes.

The longer-range impacts are much more a matter of speculation; nevertheless, I think it is worth considering what some of the possibilities may be. At a very general level, the pattern of spending a large proportion of income on relatively immediate sources of personal pleasure may reduce the ability to "delay gratification." (That is one of the connotations of the term, the "Now Generation.") More specifically, the sometimes expensive tastes developed in the teen years may be very hard to give up a few years later. If so, then saving for "big ticket" items, particularly housing, is likely to be stunted. That, in turn, is likely to have substantial impacts on society as a whole, not to mention parents who find young adults moving back home or never leaving home.

Can anything be done about changing these patterns of youth earning and spending? In my view the answer here may be closely related to the answer offered for the more specific problem of drug use—a great deal depends on the efforts of parents, particularly parents working together. The so-called "parents movement" developed largely out of efforts to control drug use. One of its key features is that parents need to share viewpoints and experiences and then work toward some shared guidelines for young people. Such guidelines need not be limited to parties, hours away from home, and substance use; another appropriate area for shared norms may involve the number of hours it is appropriate for students to be working, and the portions or amounts of their income available as "spending money" versus savings and/or contributions to the household.

One set of questions in our surveys of high school seniors asks them to rate the extent of agreement or disagreement with their parents' views about a wide range of important matters. Interestingly enough, seniors report the lowest levels of agreement for the items "How you spend your money" and "What you do in your leisure time." These are the only two items for which larger numbers of seniors report that their own ideas are "different" or "very different" from rather than "similar" or "very similar" to those of parents. By way of contrast, far more seniors agree than disagree with their parents about whether it is OK to drink or use drugs and about what values are important in life.

If parents, particularly parents working together, adopt the position that a young person's using most or all of part-time earnings as casual spending money is not, in fact, a realistic way to learn the value of money, then there is a "reasonable" basis for setting down some guidelines or restrictions. Practical approaches may be to call for a "room and board" contribution from students with substantial earnings or to require much higher proportions of earnings to be saved regularly for future needs.

I continue to believe that there is much to be gained from youth employment experiences, but I am troubled by the present patterns of earning and spending. Young peoples' views about money are an important part of their development. I am concerned that premature affluence may be teaching the wrong lessons.

[3] See Coleman *et al.*, *Youth: Transition to Adulthood* (Report of the Panel on Youth of the President's Science Advisory Committee), Chicago: The University of Chicago Press, 1974.

Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL

ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Act'l.	Projected	
	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2	1983:2	1983:3	1983:4	1984:1	1984:2	1982	1983	1984
GROSS NATIONAL PRODUCT	3,032	3,021	3,070	3,091	3,110	3,172	3,270	3,242	3,321	3,397	3,480	3,562	3,073	3,286	3,607
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	201.2	203.4	206.1	208.0	210.0	212.8	214.7	215.6	217.9	220.4	223.1	225.9	206.9	216.9	228.0
CORPORATE PROFITS AFTER TAXES	141.7	112.9	117.4	116.5	113.5	108.2	124.1	129.0	139.0	145.0	152.0	159.5	115.1	134.0	163.5
UNEMPLOYMENT RATE (percent)	8.300	8.800	9.400	9.967	10.67	10.37	10.10	10.20	9.900	9.700	9.500	9.300	9.708	10.00	9.100
INDUSTRIAL PRODUCTION (index, 1967 = 100)	146.3	141.8	139.4	138.2	135.3	138.5	144.3	141.0	145.0	148.0	150.0	153.0	138.6	143.0	155.0
NEW PRIVATE HOUSING UNITS STARTED (millions)	0.870	0.903	0.950	1.122	1.261	1.694	1.688	1.597	1.600	1.620	1.680	1.724	1.059	1.617	1.743
CONSUMER PRICE INDEX (% change from prior quarter or year)	7.2	3.0	5.3	7.8	2.0	-0.4	4.2	3.8	4.5	4.6	4.9	4.9	6.2	3.2	4.9
90-DAY TREASURY BILL RATE (%)	12.02	12.90	12.36	9.71	7.94	8.08	8.42	8.10	7.90	8.00	8.00	8.00	10.72	8.00	7.89
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	16.01	16.14	15.65	14.72	12.22	11.99	NA	11.50	11.30	11.30	11.00	11.00	14.68	11.50	11.00
GNP IN 1972 DOLLARS	1,507	1,486	1,489	1,486	1,481	1,490	1,523	1,506	1,523	1,542	1,559	1,577	1,485	1,515	1,586
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	955.7	961.4	968.8	971.0	979.6	986.7	1,010	981.0	991.8	1,001	1,010	1,020	970.2	986.0	1,023
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	176.3	173.6	167.1	163.3	160.5	159.9	162.3	161.3	162.0	163.0	165.0	168.0	166.1	162.0	169.0
RESIDENTIAL FIXED INVESTMENT (1972 $)	39.4	36.3	37.8	36.5	40.6	45.5	52.4	53.0	55.0	56.0	57.3	59.0	37.8	53.6	59.6
CHANGE IN BUSINESS INVENTORIES (1972 $)	6.0	-10.2	-3.4	-1.3	-22.7	-15.4	-4.0	-2.1	3.0	6.4	7.8	9.0	-9.4	-2.0	10.0
NET EXPORTS (1972 $)	39.9	35.2	33.4	24.0	23.0	20.5	11.0	21.5	20.0	20.0	19.0	20.0	28.9	21.2	20.0
FEDERAL GOVERNMENT PURCHASES (1972 $)	114.5	114.5	110.3	116.9	124.4	118.4	117.6	118.0	121.0	122.3	124.0	125.8	116.5	119.7	125.7
STATE & LOCAL GOVERNMENT PURCHASES (1972 $)	175.1	174.9	175.4	175.3	175.2	174.5	174.3	175.0	176.0	177.0	177.0	178.0	175.2	175.6	178.0

SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS

ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1980:3	1980:4	1981:1	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2	1980	1981	1982
GROSS NATIONAL PRODUCT	2,639	2,736	2,867	2,913	3,005	3,032	3,021	3,070	3,091	3,110	3,172	3,270	2,632	2,954	3,073
PERSONAL CONSUMPTION EXPENDITURES	1,683	1,742	1,803	1,836	1,886	1,904	1,939	1,973	2,009	2,047	2,073	2,148	1,668	1,857	1,992
GROSS PRIVATE DOMESTIC INVESTMENT	379.5	411.7	455.5	472.1	495.8	476.2	422.9	432.5	425.3	377.4	404.1	451.8	401.9	474.9	414.5
NET EXPORTS	37.1	23.3	31.9	21.1	22.8	29.2	29.9	33.3	0.9	5.6	17.0	-12.3	23.9	26.3	17.4
GOVERNMENT PURCHASES	539.1	559.0	576.3	583.5	600.3	622.8	629.8	631.6	655.7	679.7	677.4	682.1	537.8	595.7	649.2
DISPOSABLE PERSONAL INCOME	1,846	1,908	1,968	2,010	2,092	2,121	2,128	2,159	2,192	2,228	2,256	2,303	1,829	2,048	2,177
PERSONAL SAVING RATE (% of disposable income)	6.1	6.0	5.7	6.0	7.2	7.5	6.1	5.9	5.6	5.4	5.4	4.0	6.0	6.6	5.8

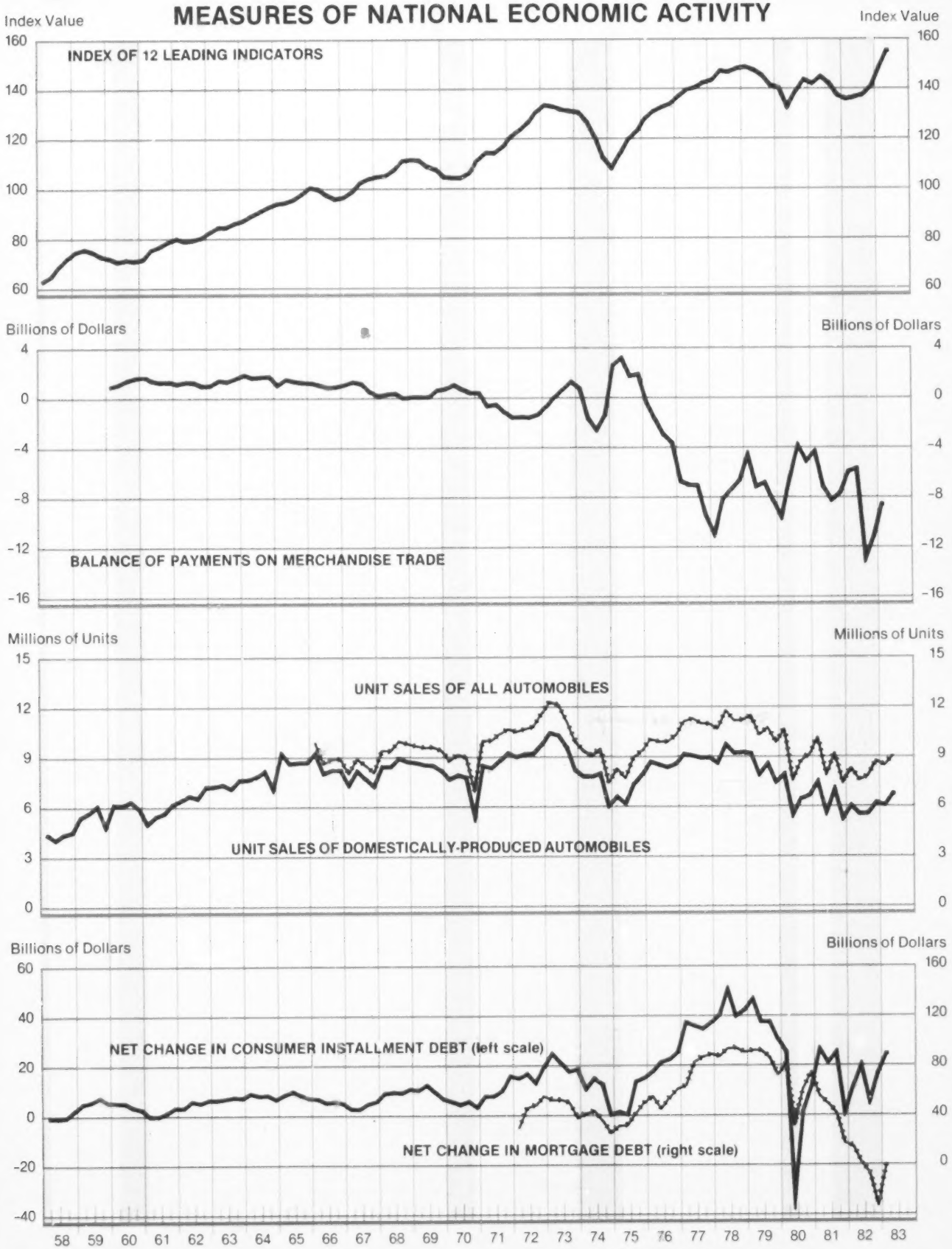
Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late August, and projected data, released by ASA-NBER in June, are displayed for second quarter 1983.

Sources: Projections: American Statistical Association – National Bureau of Economic Research panel of forecasters.
Actual Date: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

SRC MEASURES OF CONSUMER ATTITUDES

Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



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MEASURES OF NATIONAL ECONOMIC ACTIVITY

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